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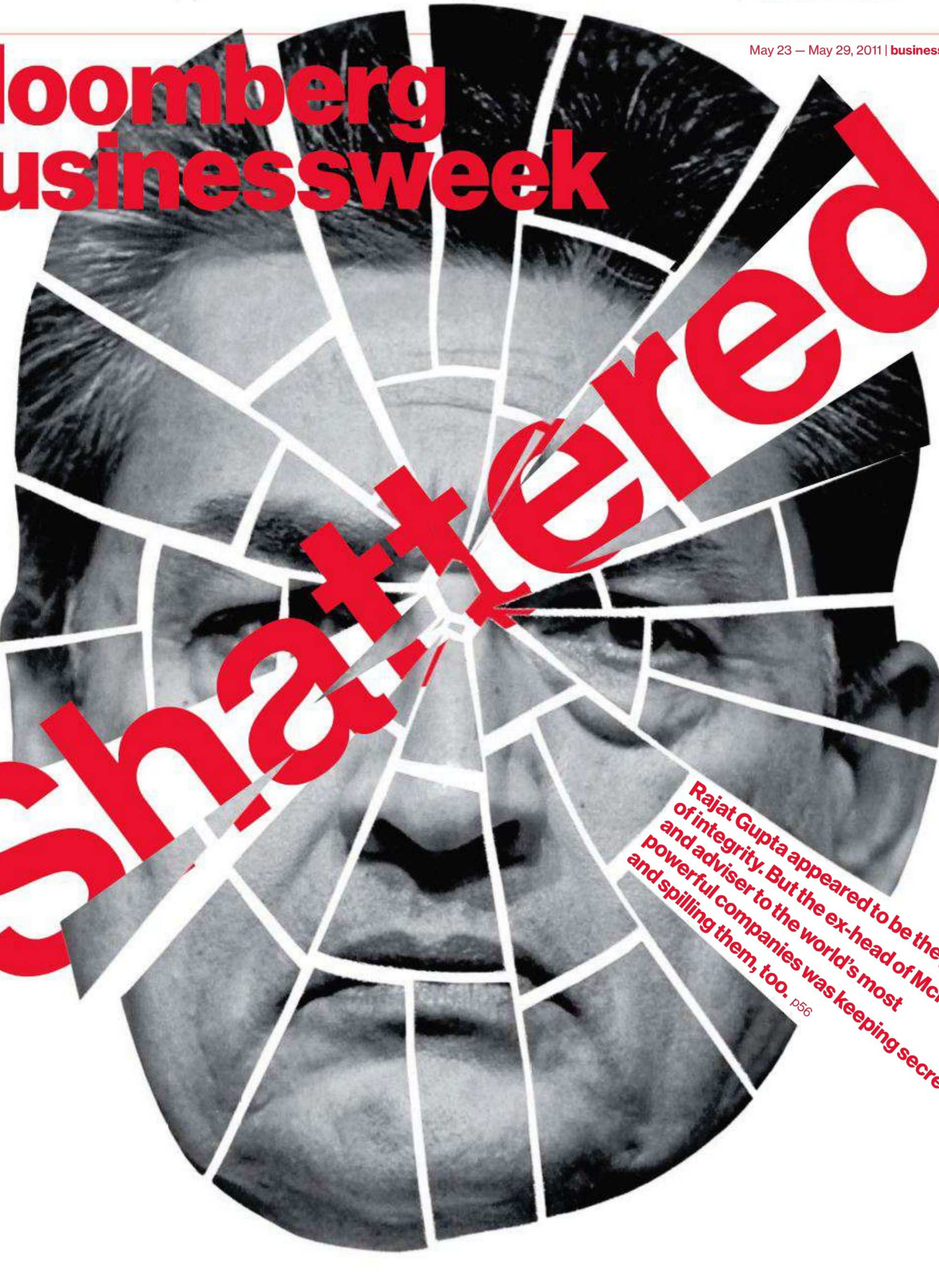
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May 23 — May 29, 2011 | **businessweek.com**

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Shattered

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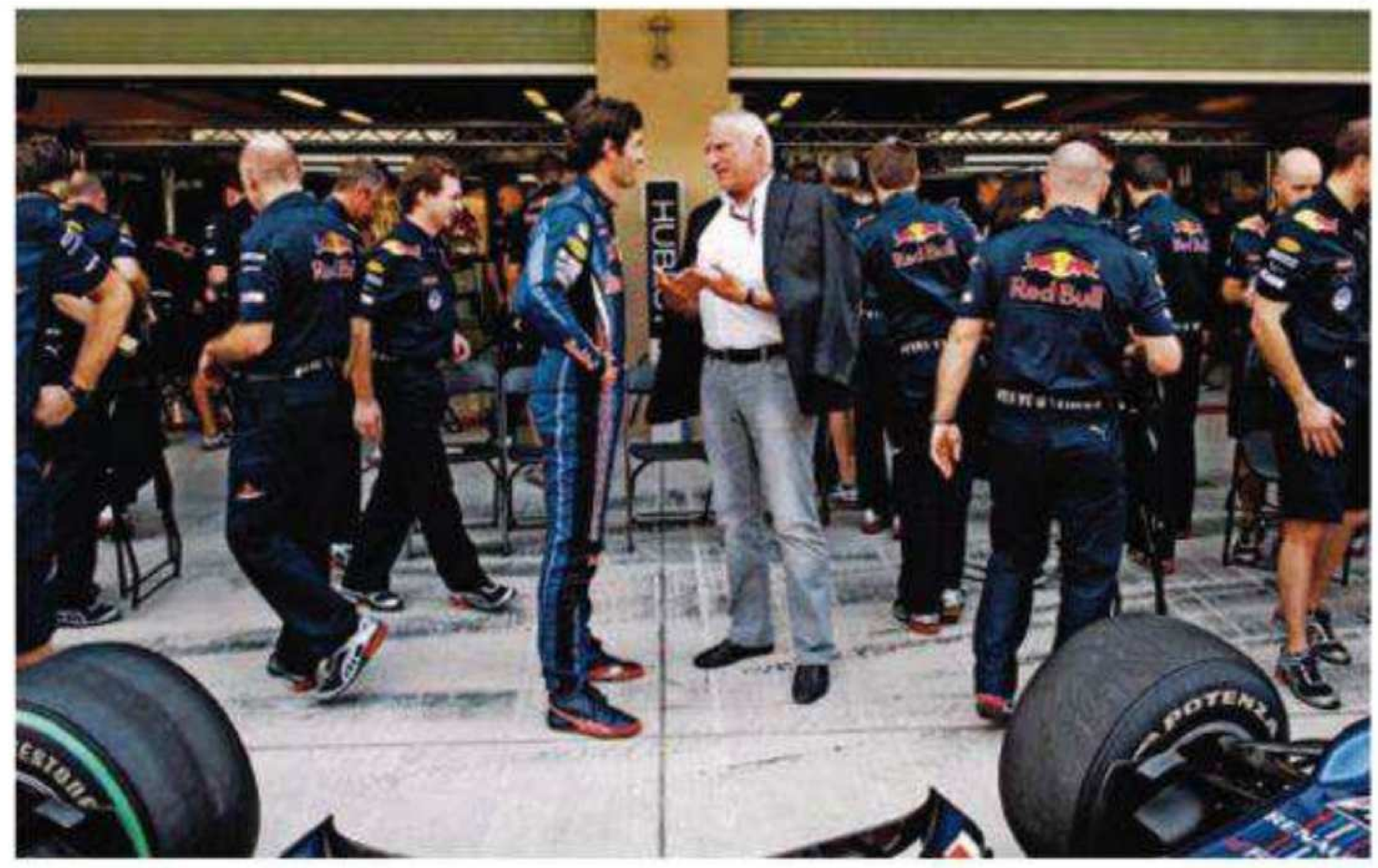
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Corrections & Clarifications

B In "Taking a Page from the Republican Playbook" (Politics & Policy, May 16-22), we misidentified Illinois Governor Pat Quinn as a Republican.

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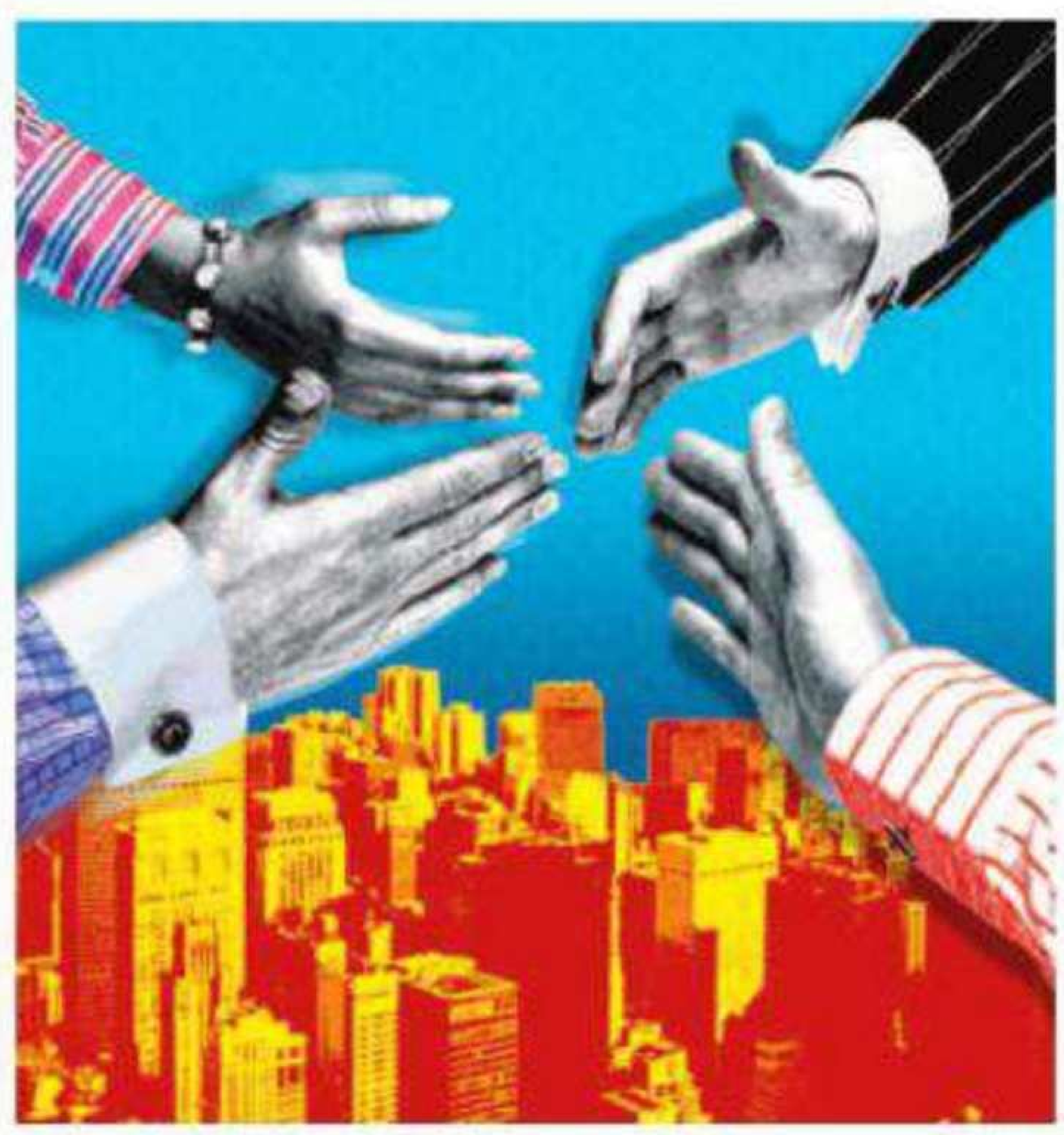
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Strength in Diversity

Wells Fargo works with national and local organizations to help diverse-owned businesses grow



MATT HERRING/IKON IMAGES/CORBIS

"We should definitely be working toward a place where we don't have to have separate programs, projects and practices for supplier diversity."

—Sonya Dukes

There are essentially two purposes behind the practice of supplier diversity. The first and most recognizable is to include and develop historically underutilized businesses as part of the supply chain. These businesses typically are women- or minority-owned operations, but also include those owned by service-disabled veterans and others. The second idea is to transform a supply chain to better reflect the demographics of a particular area in an effort to increase revenue and loyalty in that marketplace. Both ideas are good for business.

"The benefit is in several areas," says Kenton Clarke, president and CEO of DiversityBusiness.com, a leading resource for businesses that seek information related to their diversity initiatives. "It drives new innovation and creativity in the supply chain by getting input from a different kind of supplier. But also, multicultural people might be more inclined to buy goods and services from a company that they know is doing business with diverse suppliers."

As senior vice president and director of corporate supplier diversity at Wells Fargo, Sonya Dukes is responsible for spearheading the interrelated efforts of a large and far-reaching entity; there are many pieces to a puzzle of that size and dimension. Through partnerships with organizations such as the National Minority Supplier Development Council, Women's Business Enterprise National Council, several other nonprofits and their local affiliates, Wells Fargo makes itself available both financially and strategically to help identify and mentor diverse suppliers on a more personal level.

"When we look at helping diverse businesses grow, we work with organizations that are national and local to these businesses," says Dukes. "We find that this is a great way for us to stay in touch and to make ourselves available to support those businesses." Wells Fargo has also created a Leaders of Change program dedicated to helping diverse suppliers develop their businesses. (Interested companies can get more information by contacting corporatesupplierdiversity@wellsfargo.com.)

American women- and minority-owned businesses account for more than $3 trillion in revenue and employ some 25 million workers. Pat Rodgers is president and CEO of Rodgers Builders, one of the largest and most respected construction and construction-management firms in the Southeast. Rodgers Builders is familiar with both sides of the supplier diversity coin. As a woman-owned business, the company is a diverse supplier for many firms, including Wells Fargo. Additionally, as a large corporation, it has its own supplier diversity program.

"It benefits an organization to be diverse," says Rodgers, whose company collaborated most recently with Wells Fargo on a large part of uptown Charlotte's Levine Center for the Arts. "People want to see diversity in an organization that they work with. I think it benefits the entire community, brings a lot of different viewpoints, expands the potential of a work team and enriches what they do. It has a real economic impact."

Wells Fargo's Dukes would certainly agree. But she finds herself in the paradoxical position of pursuing a goal that, if attained, will put her out of a job.

"I think one of the things that we should definitely be working toward in this space is getting to a place where we don't have to have separate programs, projects and practices for supplier diversity," she says. "The mainstream sourcing practices that we have for this industry should be inclusive of supplier diversity. We still have a long journey in this work to get to that point."

Pat Rodgers has a reputation for inclusion that has benefitted her company on many levels—not the least of which is business growth. "At the end of the day it's enlightened self-interest. It's the right thing to do," she says. "But it also builds capacity." —*John Ledesma*

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Opening Remarks



7

A Downfall's Fallout

Without Dominique Strauss-Kahn watching Europe's back, the fragile bond between its have and have-not nations is in jeopardy. By Peter Coy

PHOTO ILLUSTRATION BY SEVEN-THIRTY-ONE; FLAG: CARO/ALAMY

Dominique Strauss-Kahn was buckled up and headed for Berlin on May 15 when he was yanked off an Air France jet on the tarmac, charged with the sexual assault of a hotel maid, and thrown into New York City's Rikers Island prison complex. The act for which he stands accused (and to which his lawyers say he intends to plead not guilty) is despicable. Even if he is exonerated, it's difficult to imagine how the man known as DSK could make a credible return to power. In the calculus of damage, it's not only Strauss-Kahn who will lose. It is Europe.

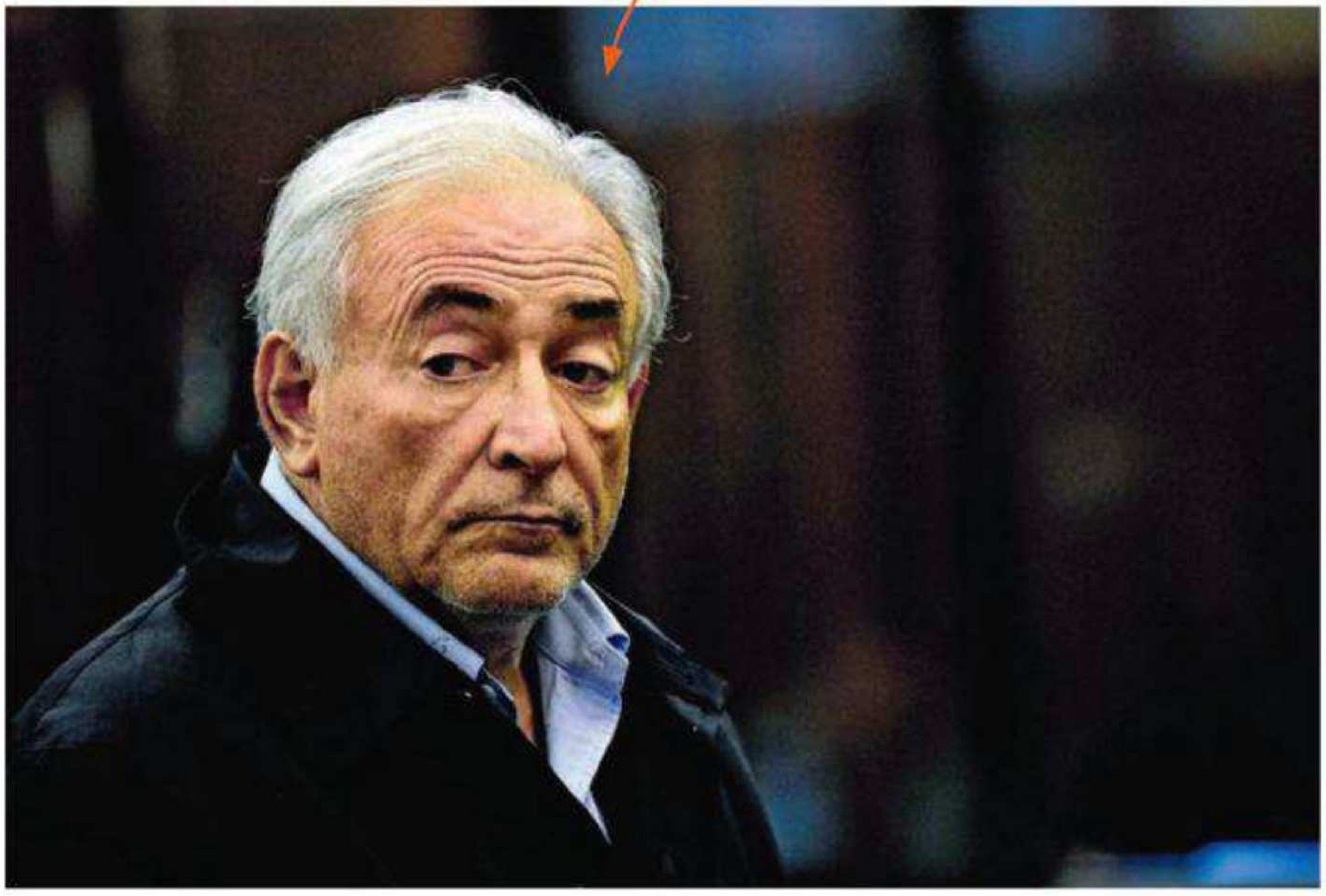
While the International Monetary Fund is a global concern, saving the European Union has been Strauss-Kahn's primary mission in recent years. "At these high levels and issues of national and global importance, personal stature and personal chemistry do matter," wrote Jan Randolph, head of sovereign risk analysis at IHS Global Insight, after Strauss-Kahn's arrest. "DSK has been involved right from the start." The IMF's managing director—a high-living socialist who was apparently hiding more paradoxes than previously known—used his charisma to keep Greek Prime Minister George Papandreou committed to politically harmful but necessary reforms. He prodded and coddled German Chancellor Angela Merkel over the design of the various bailout packages, their terms, and the need for a more permanent solution to the wider euro zone crisis, Randolph wrote. "The presumption was that with Strauss-Kahn at the helm, the IMF would not turn its back on Europe, that the IMF would continue to support Europe. Now, with Strauss-Kahn gone, that proposition becomes a little dubious," says Eswar Prasad, a senior fellow at the Brookings Institution in Washington. The next IMF chief may not be nearly as charismatic as DSK—and may not even be European.

Strauss-Kahn's departure from the scene couldn't have come at a worse moment. Little noticed in the U.S., but momentous inside Europe, was Denmark's unilateral decision on May 11 to check the papers of people arriving from other European nations. That's the equivalent of New York asking for papers at the Lincoln Tunnel crossing from New Jersey, and appears to violate the 1985 Schengen Agreement, which removed border-crossing procedures among

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Opening Remarks

Strauss-Kahn had made saving the EU his primary goal



25 European states. Ian Goldin, co-author of a forthcoming book on migration called *Exceptional People*, says Schengen is "one of the greatest achievements of Europe." German Interior Minister Hans-Peter Friedrich says that Denmark's action could set off a "spiral of mistrust." European Commission President José Manuel Barroso of Portugal warned Danish Prime Minister Lars Lokke Rasmussen in a letter that there were "important doubts" about Denmark's compliance with European and international law and cautioned him against taking "unilateral steps." Germany's *Der Spiegel* said Barroso's letter "sounded like the prologue to a declaration of war."

In the U.S., financial and demographic flows between states are large, constant, and for that reason scarcely remarked upon. Not so between the still-sovereign nations of Europe. Outside of a cosmopolitan few, Europeans' loyalty is first to their town or nation, and only then to "Europe," which, nearly two decades after the 1992 Maastricht Treaty, is still more of a landmass than an idea. Europe's equivalents of the Tea Party are populist, nationalist parties like the True Finns and the Danish People's Party, which resent Arab immigrants, the Eurocrats in Brussels, and members of the elites like Strauss-Kahn who are taking them places they don't want to go. Finland's demand for tough terms on Portugal's bailout can be traced directly to the rise of the True Finns, who captured a fifth of the vote in April elections.

The backdrop for the intra-European tension is, of course, financial distress. It's no longer fellow feeling that's keeping aid flowing to Greece, Ireland, and Portugal; it's fear. If those countries default on their sovereign debts, it will blow a hole in the banks that hold their loans and bonds. By the latest count of the Bank for International Settlements in Basel, Switzerland, foreign banks (mostly in Europe) held over $1 trillion worth of Spanish, Greek, Irish, and Portuguese debt at the end of 2010.

The latest idea, launched by Luxembourg Prime Minister Jean-Claude Juncker, is to give breathing room to debtors in a way that (it's hoped) doesn't qualify as a default that would force banks to take writedowns. It's called "soft restructuring," or even "re-profiling," a European Commission *mot du jour* that belongs in the same linguistic category as "terminating with extreme prejudice" for murder.

If Greece, Ireland, and Portugal default, it will blow a hole in the banks that hold their loans and bonds

Opposing the would-be re-profilers, European Central Bank officials are standing firm against any sort of restructuring. On May 18, Juergen Stark, a member of the bank's executive board, said a restructuring of Greek debt "would create a catastrophe" by wiping out most or all of the capital of Greece's own banks.

The friction between the nations that give and those that receive is only getting worse. Europe's richer members don't want to hand over, without strings, any more aid money; their populations won't stand for it. "Greece will have to implement huge reforms. Greece will have to rapidly, rapidly privatize many public entities," Juncker said on May 17. Only then, he said, would the EU consider further aid.

The populations of debtor nations are in no mood to swallow more austerity. Greek unions kept ferries docked at ports, grounded flights, and shut hospitals and schools in early May in protests against Prime Minister Papandreou's plans to sell state assets and usher in more spending cuts. The Irish, meanwhile, have been insisting on getting an aid package at least as generous as the ones being handed out to the Greeks and the Portuguese. The looming worry is Spain, whose economy is twice the size of those three nations' combined. The Workers' Socialist Party of Spanish Prime Minister José Luis Rodríguez Zapatero is likely to lose big in regional elections on May 22 in a rebuke of his government's austerity polices, nationwide polls show.

It doesn't help that Germany, the biggest creditor on the continent, is thriving. It's the only major nation in Europe whose unemployment rate in April was lower than it was in September 2008 (7.1 percent now; 7.6 percent then). Ireland's rose to 14.6 percent, from 7.1 percent then; Spain's to 21.3 percent in the first quarter of 2011, from 12.3 percent in the third quarter of 2008. Yoked to a single currency, the sluggish nations can't depreciate their currencies to export their way back to health. The European Central Bank is torn between Germany's need for higher interest rates to avoid inflation and the weaker countries' need for super-low rates. The compromise is a key lending rate of 1.25 percent, vs. the zero to 0.25 percent range maintained by the Federal Reserve.

Strauss-Kahn, before his arrest, had been considered a favorite to succeed Nicolas Sarkozy as French President. As one of the EU's true believers, he had demonstrated the leadership and persuasiveness needed to prod the European countries that expressed little more than a vague commitment to back up their pledges with cash. The tragedy of his downfall echoes far beyond an 11-by-13-foot jail cell at Rikers. Ⓑ

—With Marcus Bensasson and Sonia Sirletti

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☐ 50% boxes/50% envs. ☐ 75% boxes/25% envelopes
☐ 100% envelopes

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7. Number of employees at your location:
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Contents ▶ Cardboard boxes, freight cars, and the economy 12 ▶ What *l'affaire Strauss-Kahn* teaches the French 13 ▶ Fathers, sons, and Russian power plays 14 ▶ Tom Keene talks to Goldman's Andrew Tilton 16 ▶ Greenland's oil bonanza 16 ▶ Seven days ahead 18 ● Edited by Christopher Power

Volkswagen Rediscovers America

▶ **The German carmaker plans to break out of its niche in the top auto market**

▶ **"You have to be successful in the U.S. if you want to be the No. 1"**

$8,000
Difference in price between the U.S.-made Passat and the smaller yet more expensive European model

Volkswagen Chief Executive Officer Martin Winterkorn was losing patience with the staff at VW's new factory in Chattanooga. It was January, and Winterkorn had just presented a U.S. version of the Passat sedan at the Detroit Auto Show. As the plant prepared for its official opening on May 24, workers were struggling with the Passat's paint finishes, while the chrome accents in the air vents, door openings, and gear shifts didn't all shine with the same brilliance.

Winterkorn wanted to examine the chrome finishes, and the parts were hung on a wall for his inspection. Not right, said Winterkorn: He wanted them arrayed side by side in a Plexiglas case. "I have to look at the parts from above, just the way customers will in the car," explained the VW chief.

Winterkorn and Volkswagen have a lot riding on the $1 billion factory, which will assemble up to 150,000 Passats a year. The U.S. Passat sports more legroom, bigger control buttons, and more robust air conditioning than its European counterpart, and at around $20,000 it's about $8,000 cheaper, thanks to simplified designs, lower U.S. wages, and local content.

The plant opening marks the start of a renewed push by the German carmaker to shed its also-ran status in the U.S. and eventually overtake Toyota to become the world's biggest automaker. "You have to be successful in the U.S. if you want to be the No. 1 in the industry," says Winterkorn from VW headquarters in Wolfsburg, Germany. "Trends are set in America, not just for consumer behavior but also for communication technology, computers, and software." A U.S. factory can capitalize on those trends faster. Making VW cars in the U.S. also shows commitment to the market. **Toyota Motor** has 13 factories in the



Chattanooga: VW last operated an assembly plant in the U.S. in 1988

CHRIS RANK/BLOOMBERG

U.S. Even **Mercedes-Benz** has one.

Volkswagen dominates Europe, and it moved early into China and Latin America. It controls 11 percent of all car sales globally with brands including Audi, Skoda, Bentley, and Lamborghini. **Porsche** will be added to that list after VW completes its acquisition of the luxury sports car maker. Yet VW's U.S. share is a meager 3 percent, which presents a different sort of challenge to the Germans. Trying to beat out the competition "in a highly embattled market like the U.S. is somewhat unusual for VW," says Stefan Bratzel, director of the Center of Automotive Management at the University of Applied Sciences in Bergisch-Gladbach, Germany.

VW closed its only U.S. assembly plant, in Westmoreland, Pa., in 1988, after the cost of importing parts from Europe made it uncompetitive. (To avoid exchange rate headaches, the Chattanooga plant will be mostly supplied by local companies and German transplants.) Since then, VW has held on in the U.S. by appealing to drivers enamored of German technology and design yet unable to afford a **BMW** or a Mercedes. Winterkorn, who has led VW since 2007, aims to increase U.S. sales to 1 million vehicles a year by 2018, up from 360,000 now. The company's 2011 Super Bowl commercial for the U.S.-made Passat, featuring a child dressed as *Star Wars* character Darth Vader, has garnered more than 38 million hits on YouTube. It marked the start of a big marketing push for the Passat.



Volkswagen could assemble up to 150,000 Passats a year at its Chattanooga plant, shown under construction

VW's strategy relies partly on cutting entry-level prices for the Jetta compact sedan and the Passat to better compete with Japanese and Korean cars. Such bargain pricing can backfire, says Jeremy Anwyl, CEO of Edmunds.com, a website that tracks auto sales and marketing. "The formula that worked for **Hyundai** seems a little bit less characteristic for Volkswagen," he says. The carmaker won't become a heavy discounter and will maintain its premium image, says Jonathan Browning, VW's U.S. chief.

The resurgence of Detroit makes Winterkorn's task tougher. **General Motors**, **Ford Motor**, and **Fiat**-backed **Chrysler** are stepping up to Asian competition with models such as the Chevrolet Cruze, the Ford Fiesta, and the Chrysler 200, all reinventions of the classic car, as opposed to gas-guzzling trucks and SUVs.

VW offers fewer models in the U.S. than Toyota, and it ranked 31st out of 33 brands in the 2010 initial quality study by J.D. Power and Associates. Terry Jinn, 40, of Brooklyn, N.Y., chose a **Kia** Optima over the new Jetta after test-driving both. Although he liked the Jetta's looks, its performance left him cold. The Kia "seemed like a luxury car for the price, while the Jetta seemed like a cheap rental," says Jinn, who works in information technology.

Winterkorn is responding to demands from U.S. dealers for more torque to appeal to Americans' fondness for racing away from traffic lights. He visits Tampa six to seven times a year to test-drive VW and rival models in Florida's heat and humidity—conditions that don't exist in Germany.

VW has also taken pains with its U.S. factory workers. New hires get up to three months of training, including a stint at a university-like campus. That compares with two weeks of training in Germany, where recruits are often well-grounded in the industry. U.S. suppliers are being put through their paces, too. "I've done Ford, Chrysler, GM, and the quality expectation is something we've never seen before," says Jeff Fuller of Chattanooga Seating Systems. "Products are our business card for customers," says Winterkorn. "They've got to be perfect."

—Andreas Cremer and Tim Higgins

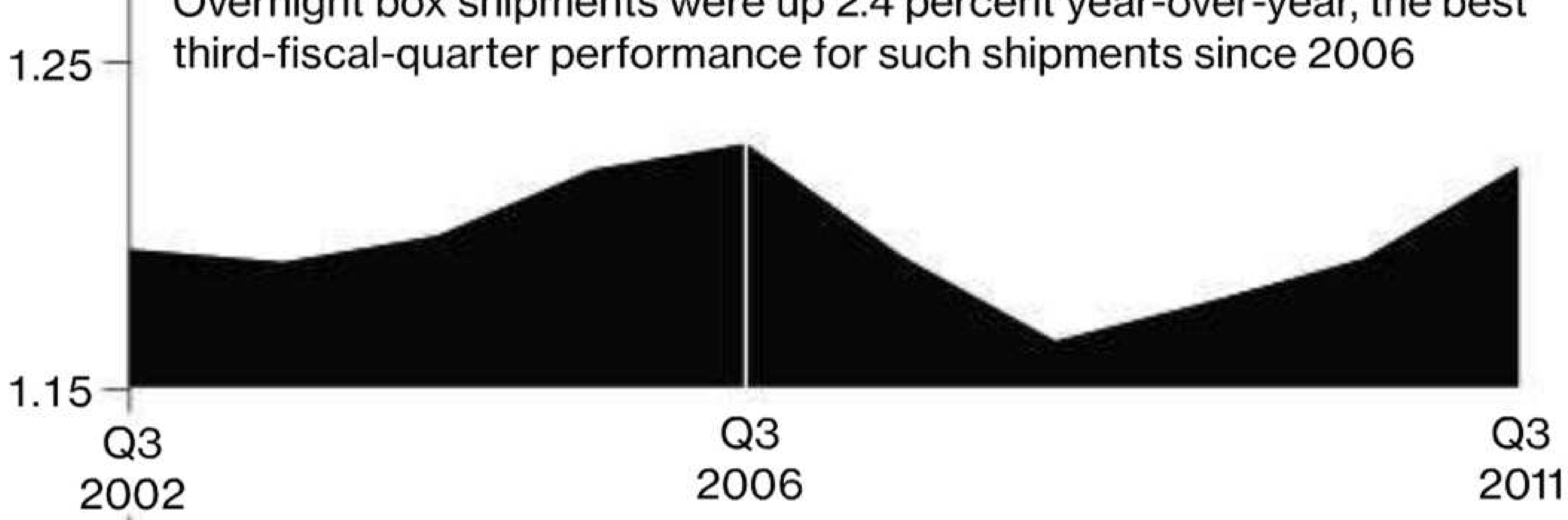
The bottom line *Volkswagen has spent $1 billion on a Tennessee factory to boost its market share in the U.S. and eventually win the top spot in global sales.*

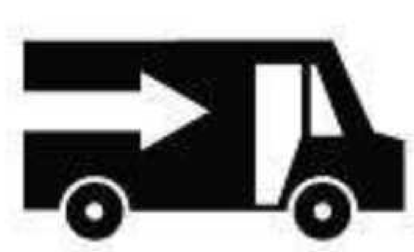
Barometers

That Box You Just Tossed Is a Clue to GDP

Besides the classic indicators of economic activity—inflation, trade data, retail sales, and payroll figures—there's a wealth of clues to be found in cardboard boxes, freight cars, and more. *—Alex Tanzi and Anthony Feld*

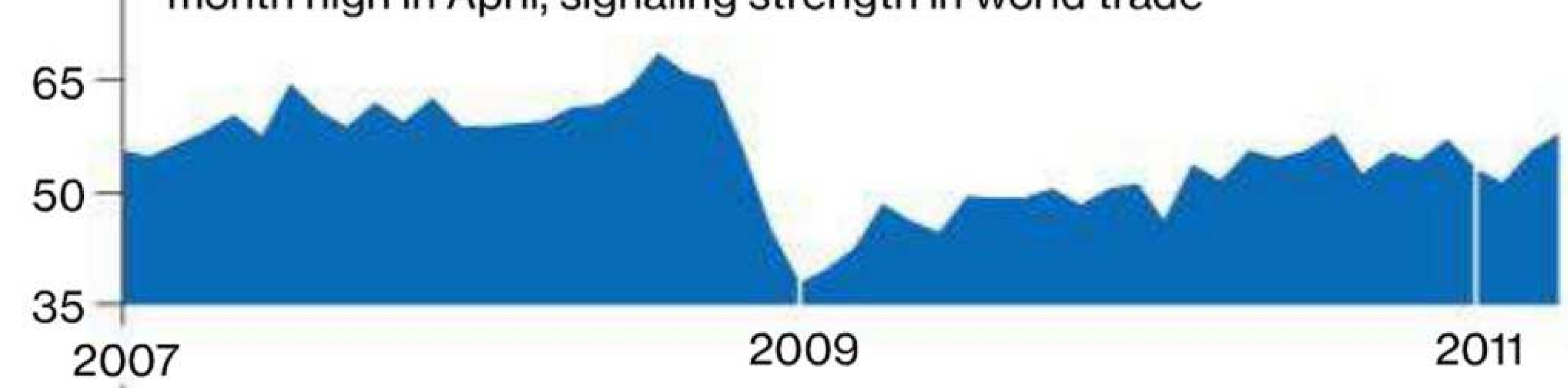
FedEx Volume: Daily Average of Overnight Boxes (millions)
Overnight box shipments were up 2.4 percent year-over-year, the best third-fiscal-quarter performance for such shipments since 2006





+4.1%
March increase in sales of corrugated boxes from a year earlier. Almost all manufactured goods are shipped in paperboard boxes

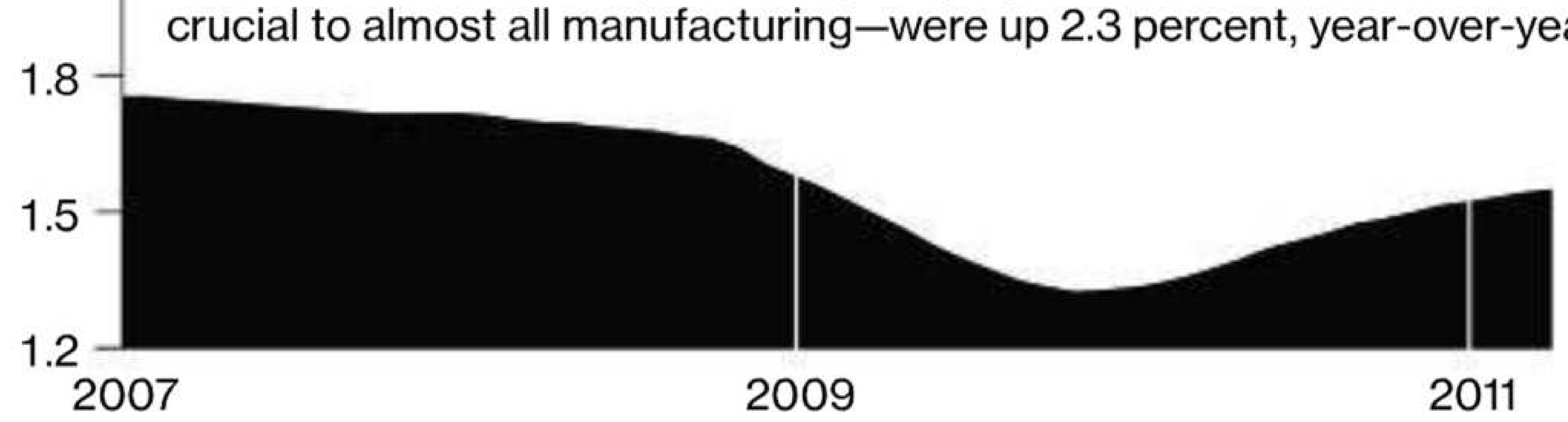
Suez Canal: Metric Tons Shipped (millions)
The volume of cargo carried through the canal rose to an eight-month high in April, signaling strength in world trade

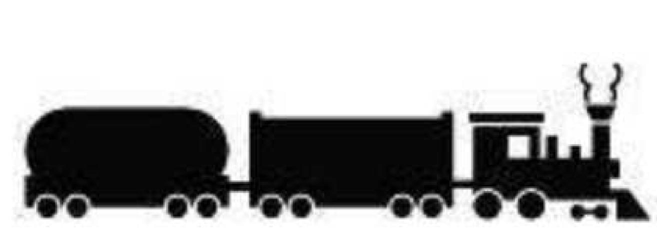




57.8m
Metric tons of cargo shipped through the Suez Canal in April of this year

Rail Cargo: Car Loads, Excluding Coal and Grain (millions)
For the week ended May 7, loadings of polymers and basic chemicals—crucial to almost all manufacturing—were up 2.3 percent, year-over-year





+5.5%
April increase in railcar volume from a year earlier

FROM LEFT: NADJA BRANDT/BLOOMBERG; ANTOINE ANTONIOL/BLOOMBERG; DATA FOR CHART: FEDEX, ASSOCIATION OF AMERICAN RAILROADS, BB&T CAPITAL MARKETS, DEUTSCHE BANK, FIBRE BOX ASSN., HAMBURG SHIPBROKER'S ASSN., AMERICAN CHEMISTRY COUNCIL

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The French give their public officials more leeway



Scandals

What *l'Affaire DSK* Teaches the French

▶ Yes, America is too puritanical: The French could be a little more so

▶ "In France, there's a real tolerance about our politicians"

The image of a handcuffed Dominique Strauss-Kahn being led to a New York jail has hovered over France for days. Among the questions the episode has raised is a particularly uncomfortable one for the French: Did their laissez-faire attitude toward officials' private lives help produce the spectacle of a respected leader charged with sexually assaulting a hotel maid?

"In truth, I am not astonished by this affair," says Jean-Paul Garraud, a parliamentary deputy who is a center-right spokesman on judicial matters. "In France, there's a real tolerance about our politicians. Maybe it's because of our monarchist past."

In the traditional French view, it's nobody's business if politicians commit adultery, pay for sex, or engage in orgies—so long as they do their jobs. Most people can see the difference between an extramarital dalliance and the violent crime Strauss-Kahn is charged with and to which he plans to plead not guilty. For French politicians, the boundaries may not look so distinct. No official in the country's recent history has been ousted over a sex scandal—and there have been some shockers. Last year, Culture Minister Frédéric Mitterrand admitted that he had paid for sex with boys on Asian vacations. He kept his job after explaining that the "boys" were of legal age.

Mitterrand is a nephew of François Mitterrand, who raised a child with his mistress, largely at public expense, while serving as President from 1981 to 1995. The arrangement was an open secret in the political and media establishment. Mitterrand's successor, Jacques Chirac, also had an eye for the ladies. In a 2001 memoir, his wife, Bernadette, wrote that she knew he had affairs but said, "My husband always came back." Calls to the former President's office in Paris were not immediately answered.

One French journalist called Strauss-Kahn's relations with women a "problem." Few others paid attention

Similarly, Strauss-Kahn's aggressive pursuit of women was well known in France, yet little was said about it. One of the few to raise the alarm when Strauss-Kahn was named in 2007 to head the International Monetary Fund was reporter Jean Quatremer from the leftist newspaper *Libération*. Calling Strauss-Kahn's relations with women a "problem," Quatremer wrote, "He often skates close to harassment."

Against that backdrop, it wouldn't be surprising if some French politicians figured they could do as they pleased. What's more, they might be right: If a hotel chambermaid in France complained of being assaulted by a prominent politician, Garraud says, "I'm not at all sure that it would be treated as it has been by American justice."

Strange as the French might find it, a similar situation existed in the 1980s in Arkansas, when Bill Clinton was governor. Clinton was often on the prowl for sexual conquests—a fact well known to local news media because he sometimes made advances toward women journalists. Yet nothing was reported about it.

After Clinton became President, several women came forward publicly with allegations of sexual misconduct. Although never charged with any wrongdoing, Clinton in 1998 agreed

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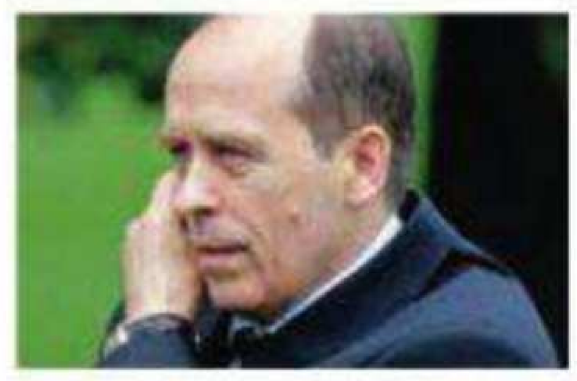
to pay $850,000 to settle a sexual-harassment lawsuit from Paula Jones, a former state worker who said Clinton had summoned her to a hotel room where he exposed himself to her. He denied Jones's account yet was held in contempt of court and fined after a judge found he had given misleading testimony. Clinton's relationship with White House intern Monica Lewinsky came to light after Jones's lawyers subpoenaed witnesses to show that Clinton had a pattern of inappropriate behavior with women. Clinton's office didn't respond to requests for comment.

Clinton's impeachment in *l'affaire Lewinsky* was "incomprehensible to the French spirit," said *France Soir* in an article on DSK's arrest. In the past five years sex-related controversies have ended the careers of two governors and at least six members of Congress. Recently, Representative Christopher Lee of New Jersey resigned after admitting he had sent a shirtless picture of himself to a woman while trolling for dates on Craigslist. In some cases an extramarital romance can trigger something bigger. Former Nevada Senator John Ensign resigned on May 3 after details came out about his affair with an aide. His behavior sparked an ethics investigation of payments and favors given to the woman and her husband. The Justice Dept. is looking at the case. —*Carol Matlack*

The bottom line *The Strauss-Kahn scandal highlights the risks of ignoring politicians' private lives, which can disrupt government.*

Family Connections

A peek at Russia's power elite



Alexander Bortnikov

Director of the Federal Security Service (FSB). Son Denis is a senior executive at Russia's No. 2 bank, VTB.



Mikhail Fradkov

Former Prime Minister, now head of the foreign intelligence service. Son Pyotr is deputy chairman of Vnesheconombank.



Sergei Ivanov

Deputy Prime Minister under Putin. Son Sergei was just tapped to head the supervisory board of Russian Agricultural Bank.



Valentina Matviyenko

Governor of St. Petersburg. Son Sergei heads the real estate arm of VTB.



Arkady Dvorkovich

Economic aide to President Dmitry Medvedev. Wife, Zumrud Rustamova, is on the board of Sheremetyevo International Airport.



Nikolai Patrushev

Head of Russian Security Council. Son Andrei is adviser to the chairman of state oil company Rosneft. Son Dmitry is CEO of Russian Agricultural Bank.

DATA: BLOOMBERG

CLOCKWISE FROM TOP LEFT: PHOTOXPRESS/ZUMA PRESS; KRISTA KENNELL/EFE/ZUMA PRESS; THIBAULT CAMUS/AP PHOTO; PHOTOXPRESS/ZUMA PRESS; ALEXANDER ZEMLIANICHENKO JR/BLOOMBERG; HFP/ZUMA PRESS

Governance

Fathers, Sons, and Russian Power Games

▶ The sons of Putin allies land in key positions at state companies

▶ "This problem is extremely serious because it creates a feudal regime"

In early April, Russian President Dmitry Medvedev announced that top government officials—many of them allies of Prime Minister Vladimir Putin—had to relinquish their board seats at Russia's state-controlled companies. It seemed like a shrewd way to improve corporate governance in one stroke. Putin, the former President and possible candidate for the presidency in 2012, said nothing in public about the order, which the Prime Minister has to carry out.

The friends of Putin, it turns out, have adult children who can fill in for their fathers and their allies. Sergei Ivanov is Deputy Prime Minister under Putin and a member of Putin's inner circle. His son, Sergei Jr., was until April a top executive at **Gazprombank**, an arm of the state-controlled energy giant. Sergei Jr. is now Putin's candidate to replace First Deputy Prime Minister Viktor Zubkov as head of the **Russian Agricultural Bank**'s supervisory board. Zubkov, another close associate of Putin's, was one of the eight top officials ordered by Medvedev to vacate their board seats.

The Kremlin is "not satisfied" with all the candidates to replace the eight top officials in the 17 board positions, says Arkady Dvorkovich, the President's economic aide. He declined to endorse Ivanov's appointment. According to Putin's spokesman, Dmitry Peskov, however, Sergei Jr.'s appointment has been approved by Putin's Cabinet. All the offspring mentioned in this story declined to comment.

The Ivanov episode is a reminder of how close-knit the ruling class is. "There are 50 families that rule Russia," says Marina Litvinovich, a political activist who formed a think tank that reports on family connections in the power structure. "These are families of Putin administration officials, Putin's friends, presidential administration officials, and some businessmen."

Putin's move angers Alexei Navalny, a minority shareholder activist who campaigns for better governance at state companies. "This problem is extremely serious because it creates a feudal regime," says Navalny. "I'm skeptical that this decision to remove officials from state company boards will have an effect because all these companies under state control are turning into the personal property of these officials through their children." Navalny himself is under investigation for allegedly causing losses at a state company, a probe he says is meant to discredit him.

At the Russian Agricultural Bank, the 31-year-old Ivanov would be working with Chief Executive Officer Dmitry Patrushev, whose father leads Russia's Security Council. The older Patrushev once worked as a director of the Federal Security Service (FSB), the main

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Marketing lessons from Brand Oprah
page 20 ▶

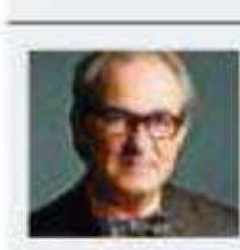
Tom Keene's EconoChat

Tom talks with **Andrew Tilton,** senior U.S. economist for Goldman Sachs, about the outlook for the rest of 2011

Give us an update on GDP here. You guys have been cautious.
I think we are still looking at around 3.5 percent growth in the first half, maybe a touch slower in the second half of the year. Overall, the first quarter was certainly a disappointment.

Is the slowdown of stimulus going to drag the economy to lower GDP?
Yes. We do need a very large fiscal adjustment. At least 6 percent of the budget deficit is structural–that is, growth alone won't solve the problem. The research in this area has generally shown that fiscal adjustments that rely more on spending cuts tend to result in a better outcome than adjustments that focus on taxes. Yet there is no doubt that in the short term–the short term being the first few years of budget cutting–you will see a growth hit from a big budget adjustment. We are assuming that this takes about a point off GDP growth.

What is the dynamic of mortgage finances now?
In the years of the boom, people were borrowing cheaply against their houses to buy SUVs, new plasma TVs, or whatever the case may be. That has clearly ended. Now, in part because of the drop in home prices, you actually have a paying down of mortgage debt. So that particular fuel for consumer spending is gone. Going forward, the fuel for consumer spending growth is going to have to come from the labor market, from employment growth, from wages growing, and so forth. Ⓑ



Keene hosts Bloomberg Surveillance *7-10a.m. ET on 1130AM in the NY metro area & nationally on SiriusXM 113.*

successor agency to the Soviet-era KGB, while Sergei Ivanov Sr. was a colleague of Putin in the KGB itself. Sergei Jr.'s brother, Alexander, is the head of structured and credit financing at **Vnesheconombank**, a state-controlled development bank. Their father sits on the bank's supervisory board.

There are other examples. The son of the head of the FSB holds a top job at Russia's No. 2 bank. Pyotr Fradkov, the deputy chairman of Vnesheconombank, is the son of the head of the Foreign Intelligence Service, which replaced the KGB's foreign intelligence department.

Medvedev, a 45-year-old former corporate lawyer, is trying to improve business practices and turn Moscow into an international financial hub. If he could weaken the 50-family structure, he would push Russia further toward a more transparent system that would appeal to investors, says Litvinovich. Putin spokesman Peskov says the number of state company officials related to government members is small and no worse than elsewhere. Besides, he adds, "They all have to prove themselves from a professional point of view."

Medvedev has powerful associates, too. Dvorkovich's wife, Zumrud Rustamova, sits on the board of state-run Sheremetyevo airport and is an executive at **Polymetal**, a gold producer. Rustamova says she earned her status through "hard work and luck" and built her career before she met her husband.

The President's struggle to block Ivanov's appointment is an indication of the limits to his authority, says Alexei Mukhin, director of the Moscow-based Center for Political Information. "Dmitry Medvedev, according to the constitution, is an independent politician, but he doesn't have real autonomous power," he says. Putin, who stepped down as President in 2008 because of a ban on serving more than two consecutive terms, earlier this month formed a nationwide coalition of supporters who will field candidates in December parliamentary elections. Both he and Medvedev say they may run for President.

The sons of the elite are not necessarily ill qualified. Sergei Ivanov Jr. is "a smart guy, and he's got a good track record," says Michael Kart, a managing partner at Moscow-based **Marshall Spectrum**, an emerging markets equity manager. Yet Kart adds: "It would definitely be a great advantage to promote somebody else outside of the inner circle. A state company shouldn't be regarded as a family business."

Russian politicians' clans play a role similar to those in Asia, Africa, and Latin America, says Yelena Panfilova, the head of Berlin-based Transparency International's local office. One comparison, Panfilova says, is Indonesia under Suharto, who ruled for three decades until street protests ousted him in 1998 and whose family had extensive business activities. In Russia, the practice extends to the regions, where children of governors often dominate local enterprises. Says Panfilova: "It's a serious problem, and it's very harmful to the economy."
—Henry Meyer and Ilya Arkhipov

The bottom line *The sons of Putin's allies have started to assume important positions in Russia's corporate power structure.*

Natural Resources

In Greenland, An Arctic Growth Story



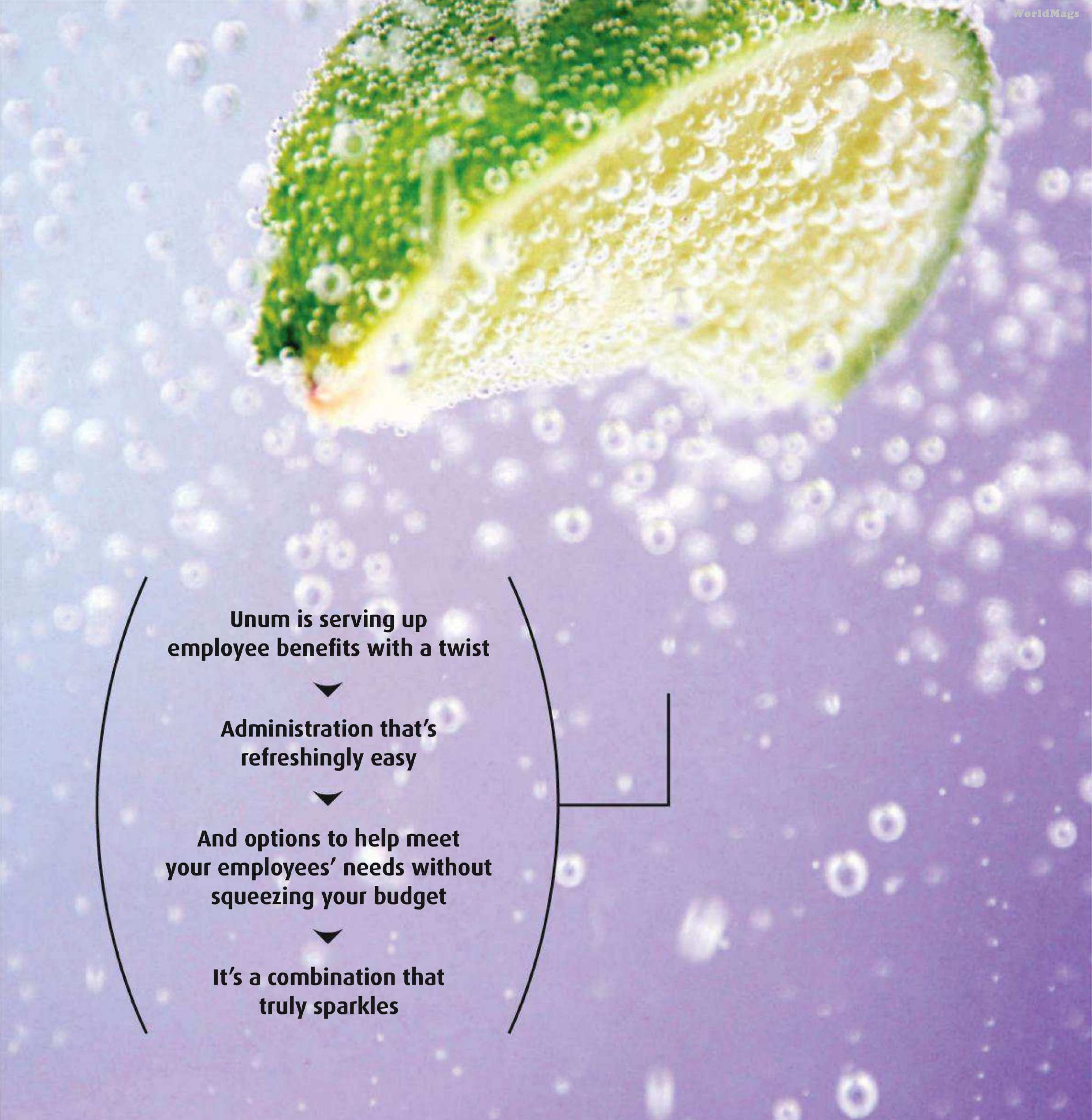
▶ The Danish possession has high hopes for this summer's oil drilling

▶ "We can free ourselves from Denmark's domination"

Greenland's capital of Nuuk (pop. 15,000) was turned upside down by the arrival on May 11 of U.S. Secretary of State Hillary Clinton. She was there for a meeting of the Arctic Council, an eight-nation group that's trying to figure out how to manage the region's growing industrial activity while protecting the ecosystem and native rights.

Greenland's role as host of the meeting highlights its growing importance in the drive to exploit the riches of the Far North. **Cairn Energy**, a Scottish explorer of oil, just received approval

FROM TOP: POLARIS; SLIM ALLAGUI/AFP/GETTY IMAGES; ANDREW HARRER/BLOOMBERG



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Global Economics

from Greenland authorities to drill four exploratory wells in the chilly waters west of the island. Last year, Cairn drilled two wells that uncovered evidence of oil and gas in the same area the company plans to probe more extensively starting in early June. Oil majors **Royal Dutch Shell** and **ExxonMobil** have expressed interest in Greenland as well.

Geologists have long known that oil, iron ore, zinc, nickel, and diamonds were likely to be found in Greenland. Now oil is well over $60 a barrel, the threshold price for making Arctic drilling profitable. Receding sea ice, meanwhile, has lengthened the drilling season. And mineral deposits, including zinc, have been uncovered as the inland ice recedes.

While Greenland, a Danish colony for almost 300 years, was granted home rule in 1979 and broader domestic governance in 2009, it still relies on an annual subsidy from Denmark of about $674 million, or 30 percent of the economy. With the hope of an oil bonanza, "there's a stronger belief that we can free ourselves from Denmark's economic and political domination," says Greenland's Prime Minister, Kuupik Kleist.

The numbers, in theory at least, are alluring. Greenland's waters may hold 48 billion barrels of oil equivalent, the U.S. Geological Survey estimates, almost double 2009 U.S. oil reserves. The Citronen Fjord zinc deposit may be one of the world's biggest, according to Greenland's Bureau of Minerals and Petroleum. **London Mining** is investing $2 billion in an iron ore project north of Nuuk.

An unsettling aspect of Greenland's development is the role of global warming. The annual temperature increase in the Arctic since 1980 has been twice as high as in the rest of the world. That means the Arctic Ocean may be largely ice-free during the summer by 2050, according to the Arctic Monitoring and Assessment Program, an international environmental group. For now, the Greenlanders are being practical: The melting makes it easier for miners and drillers to do their work. And the island may be able to generate more revenue from shipping as once-impassable routes open up, says Kleist. B

—Marianne Stigset

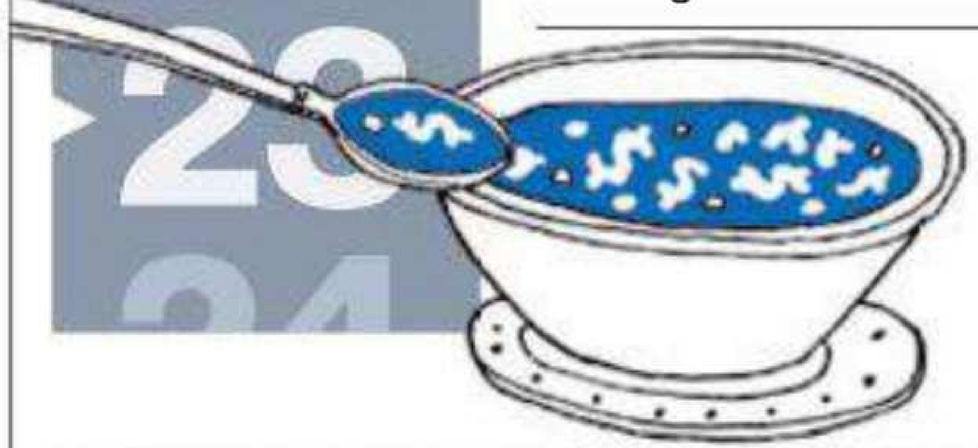
The bottom line *With up to 48 billion barrels of oil equivalent, Greenland may prove to be a critical player in the race to develop the Arctic.*

Events of note in the week ahead

Seven Days

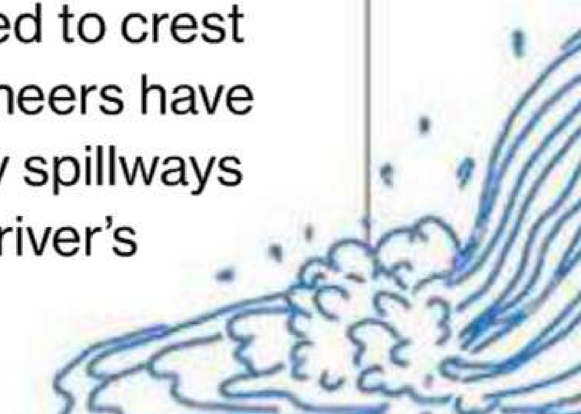
by Ira Boudway

23



Campbell Soup reports earnings

▶ **Flood peak in New Orleans:** The Mississippi River is expected to crest in New Orleans. Army engineers have already opened emergency spillways upstream to help stem the river's worst flooding since 1927.



24

U.S. new home sales

Germany's leading economic index



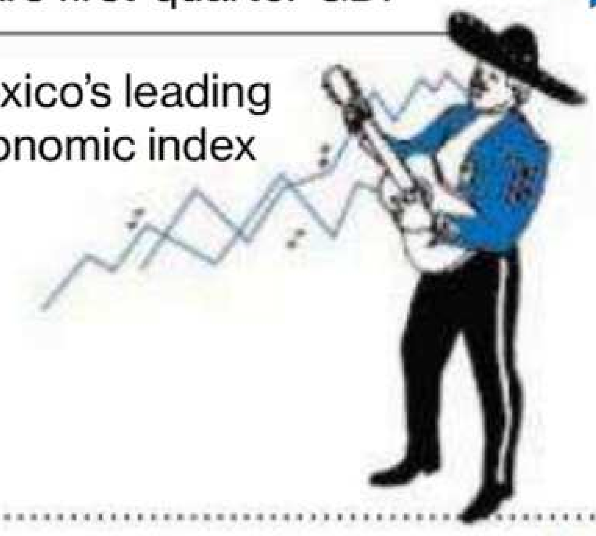
▶ **India-Africa Summit:** Indian Prime Minister Manmohan Singh speaks to African leaders in Addis Ababa.

▶ **Netanyahu in Washington:** The Israeli Prime Minister addresses a joint session of Congress.

25

U.K.'s first-quarter GDP

Mexico's leading economic index



▶ **Costco earnings:** Membership fees have helped boost profits at the largest U.S. warehouse club as shoppers regain confidence. Analysts expect $20 billion in sales for the quarter.



26

Freescale Semiconductor IPO

Japan's consumer price index



▶ **Hong Kong International Art Fair:** Close to 20,000 visitors are expected for the four-day exhibition featuring contemporary works from 260 galleries worldwide.

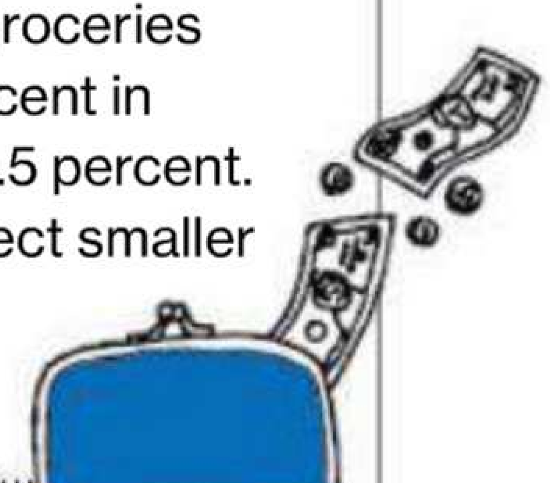


27

Christie's Château Latour rare wine auction in Hong Kong



▶ **U.S. personal income and spending:** Rising prices for gas and groceries drove spending up 0.6 percent in March. Incomes climbed 0.5 percent. Surveyed economists expect smaller increases for April.



28

Bank of Japan Governor Masaaki Shirakawa speaks in Tokyo

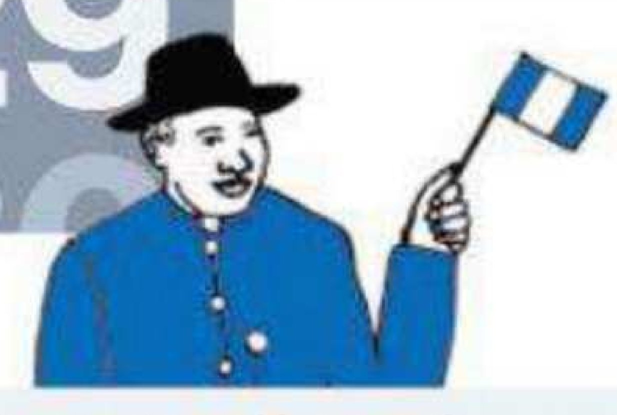


▶ **Champions League final:** Barcelona and Manchester United vie for supremacy in European club soccer at London's Wembley Stadium.

▶ **Malta:** Voters decide on a nonbinding resolution to legalize divorce.

29

Goodluck Jonathan sworn in as president of Nigeria



▶ **Indy 500:** Some 250,000 fans are expected at the Indianapolis Motor Speedway for the 100th anniversary of the auto race. Last year's winner, Dario Franchitti, took home $2.75 million.



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GEORGE BURNS/HARPO, INC./LANDOV

Marketing Lessons From Brand Oprah

▶ **The Queen of Talk sold refrigerators, bras, books, and herself**

▶ **"I'm hard-pressed to think of a stronger brand than Oprah"**

In 1988, Oprah Winfrey made a decision that would change her life—and eventually the future of television. Her talk show was already getting better ratings than kingpin Phil Donahue and aired in 198 markets. When she renegotiated her contract with King World Productions, which syndicated her show, and with ABC, which produced it, Winfrey demanded control and got it. Winfrey's **Harpo Productions** assumed the show's production costs, but it also collected licensing fees from local stations, estimated at $100 million in 1988. Plus, Harpo earned money from a few lucrative moments of advertising each day. "I never wanted to be in a position again in life where I was meant to do something but couldn't do it because somebody was telling me I couldn't," Winfrey later told writers of a Harvard Business School case study.

The impulse to take control of her life—and then enjoy it—resonated with her viewers over a 25-year span that will end on May 25, when she airs her finale on broadcast television and turns her attention to her new cable channel. Over that time, Oprah became a singular brand born of her own personal history. Winfrey's story of childhood poverty

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THE END OF AN ERA



Taping her talk show outside the Sydney Opera House in December

and sexual abuse, her struggle with her weight, and her striving and charisma made her the near-perfect peddler of a relentless optimism. She was more than a celebrity: She stood for self-improvement, doing good, and controlling your own destiny. Her motto, "Live your best life," was invoked on her show, in her magazine, and on her website.

It all added up to a brand radically different but no less powerful than Coca-Cola or the Marlboro Man. It propelled her show, which drew about 12 million viewers in the U.S. at its peak, through more than 4,500 episodes and some 30,000 guests. She stayed on message as she launched her magazine and produced movies and developed a raft of syndicated television shows including those of Dr. Phil McGraw and Rachael Ray. The brand ultimately made the meticulously manicured entrepreneur very rich, with an estimated fortune of $2.7 billion, according to *Forbes.* "I'm hard-pressed to think of a stronger brand than Oprah, and I've studied 200 years of brands," says Harvard Business School professor Nancy F. Koehn.

Winfrey's other great talent was to combine her message with a rousing consumerism absent even a hint of irony: Treat yourself! You deserve it! Her viewers and readers bought in and bought big. The brand's marketing fairy dust was sprinkled on an array of products she endorsed without compensation, somehow adding to her already robust credibility. One day she might talk about age-defying makeovers, the next about the faces of autism; she went to Ethiopia; she went green; she went vegan. And then she went shopping. "For her, transformation is about self-esteem and about buying stuff," says Susan Mackey-Kallis, a communications professor at Villanova University. "It's consumerism, but it's not crass."

After a quarter century as a daily staple on broadcast television, Oprah's influence is unparalleled

Winfrey, who declined comment for this story, has helped turn her favorite books into bestsellers and



Don't touch our tax break! page 29 ▶







her favorite things into instant successes. After she recommended Eckhart Tolle's *A New Earth* in January 2008, it topped the bestseller list on **Amazon.com**. Within a month, Penguin Group had shipped 3.5 million copies. Her "Oprah's Book Club" plugged 65 books and was credited by some with saving the publishing industry.

Winfrey regularly announced her "favorite things" in shows that were tantamount to infomercials, though far more effective. When **DreamTime's** Foot Cozys, aromatherapy slippers, were featured on an episode in 2002, the company was selling 3,000 pairs a month. The following month, it sold 20,000. The slippers became DreamTime's best-selling product that year. When Winfrey presented such goodies to her audience, it was the companies (from **Williams-Sonoma** to **Apple**) that donated them. The big shows—in which audiences received cars and trips—inspired the fervor of revival meetings. "Product placement is a fair way to describe her 'favorite things,'" says Kevin Lane Keller, a marketing professor at Dartmouth's Tuck School of Business. "But she is the one who is brokering those deals for her audience. It's product placement in a funny kind of way because the companies are giving the product away." Her brand could sell everything from croissants to refrigerators. Chicago blogger Robyn Okrant bought everything Winfrey recommended in 2008, spending nearly $4,800.

Like any great marketer, Winfrey has sought to extend her brand's reach. She has launched the TV careers of other live-your-best-life gurus, such as Dr. Oz and the designer Nate Berkus—whose shows Harpo developed. She even made her personal trainer, Bob Greene, a celebrity. He now sells his own fitness and diet books. "She creates this army of celebrities who are all part of the same campaign," says Mackey-Kallis. "That's an economy of scale and lets her have an exponential impact."

Winfrey's empire also includes a monthly magazine published by **Hearst**, *O, The Oprah Magazine,* that combines her do-good and enjoy-good-things ethos and has a circulation of about 2.5 million. (She's been on the cover of every issue.) Even most of Harpo's feature films and television movies—including *The Great Debaters* and *Tuesdays with Morrie*—have been emotionally rich dramas about reinvention.

Winfrey has stoked some controversy along the way. She gave credence to Suzanne Somers's questionable anti-aging hormone and vitamin regimen and Jenny McCarthy's book linking vaccines and autism. Her school for girls in South Africa was hit with allegations of sexual abuse. Yet these embarrassments barely affected Winfrey's standing. "Her moral character hasn't been questioned," says Keller. "There haven't been any personal transgressions." The resilience of her brand didn't surprise the experts. "All strong brands are authentic, relevant, and different," says Josh Feldmeth, chief executive officer of consultancy **Interbrand**'s New York office. "Oprah performs as well as anything in the market today."

Still, as Winfrey prepares to move to cable, there are signs she's preparing her brand for a shift. In October she appeared via satellite on Comedy Central's *The Daily Show with Jon Stewart* and announced she was giving everyone in the audience a free trip to Washington to attend the rally that Stewart and Stephen Colbert were organizing.

65%

Share of Americans who viewed Oprah favorably in a 2009 Gallup poll

"She was going on Jon Stewart's show to cash in on his cultural power," says Robert Thompson, a professor of popular culture at Syracuse University. "She wanted to start courting younger viewers for her cable network. It was the first time we saw Oprah trying to suck the cultural mojo from someone else."


Janice Peck, author of *The Age of Oprah: Cultural Icon for the Neoliberal Era,* points out that Winfrey is a baby boomer, and that "her historical moment is passing." Even Feldmeth says the big trends are no longer in Winfrey's favor. "If credibility and expertise come more from our social networks, are we still going to be sitting at the feet of a master like Oprah?" he asks. —*Susan Berfield*

The bottom line *The power of the Oprah brand has sold Winfrey's talk show, magazine, and hundreds of products. She'll now test it on cable.*



CLOCKWISE FROM TOP LEFT: ARISTIDE DE SEGONZAC/POLARIS; HARPO, INC./GEORGE BURNS; JOHN GRESS/REUTERS; CHICAGO TRIBUNE/GETTY IMAGES

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TWITTER

Twitter's share of U.S. Web traffic jumped 24 percent the day Oprah tweeted live on air

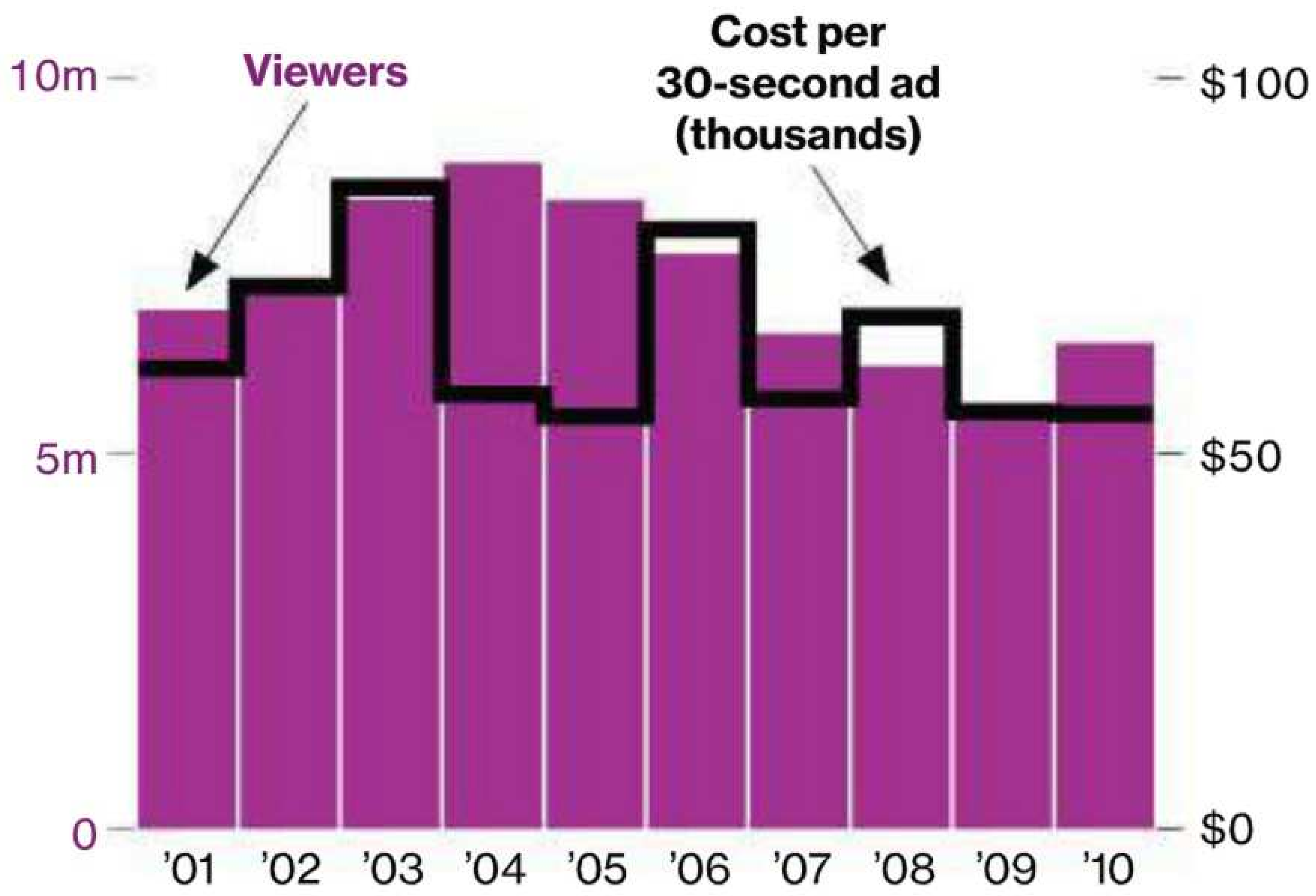
OBAMA

Oprah's stumping for Obama gained him 1 million votes, according to a study by professors at the University of Maryland



Advertisers Are Sold on Oprah

Marketers like Winfrey's huge female audience



Ads airing during Oprah's final show are said to cost $1 million, putting her in league with prime-time finales

	Finale audience	Cost per thousand viewers
Oprah	**10 m***	**$100.0**
24	8.9 m	$73.0
Lost	13 m	$66.2
Friends	52 m	$44.4
Seinfeld	76 m	$24.9

*PROJECTION DATA: HORIZON MEDIA, NIELSEN

The Anointed

Riding the Oprah Wave, Ready or Not

▶ Many small outfits that get the nod struggle to meet demand

▶ "Her endorsement is worth its weight in gold"

When Sam Greenberg got the call in the fall of 2003, he was sitting in his office at the East Texas purveyor of smoked turkeys his father founded during the Great Depression. A producer from *The Oprah Winfrey Show* was on the line to see if Greenberg would give 400 of his hickory-smoked fowl away to a studio audience. As they talked, Greenberg glanced out his window onto the sales floor and saw dumbstruck employees staring at him. One held up a sign that read: "Oprah's on line three."

Winfrey got right to the point. "Can you handle it? Can you get the turkeys out?" Greenberg recalls her asking, eager to make sure the flood of attention wouldn't overwhelm him. Greenberg said he would, knowing full well what an introduction to millions of Oprah's diehard fans could mean for a company with a dozen full-time employees. "We'll be fine," he said. Then Winfrey asked to be transferred to someone who could take her own order; turns out she'd been buying Greenberg's turkeys ever since receiving one as a gift.

Greenberg Smoked Turkey of Tyler, Tex., was about to star on Oprah's Favorite Things, an annual show that earned its own spoof on *Saturday Night Live* for all the shrieking from the audience when Winfrey showered them with gifts, from **LG** fridges to **Volkswagen** Beetles. For makers of the more than 160 products that have appeared on those shows, plus scores more that received even a passing nod on Oprah's website or in her magazine, it's like winning the Lotto.

It was brave of Greenberg to so blithely say he was ready for the Oprah Effect, that brief, bright bump that's become the Holy Grail of businesses everywhere. Despite selling about 150,000 birds a year, the company had no website and didn't accept credit cards. What's more, the show was 12 days away and the turkeys took four days to smoke. Greenberg first alerted existing customers that a surge in demand was coming, thanks to vaguely described media attention, and that they'd be wise to order now. Next, the company boosted production by 10,000 by squeezing more turkeys into its 20 smokehouses and running them 24/7. A makeshift website was built to take orders, though buyers could pay only by check.

On the big day, Winfrey raved about the turkey for 42 seconds and the company's 20 phone lines lit up. The business normally signed up 5,000 new customers annually. In the two weeks post-Oprah, 22,000 first-timers came calling at an average of $50 per order. The turkeys sold out by Dec. 10, a holiday season record. "To mention my product for 42 seconds and to sell $1 million worth of turkeys, that's a lot of power," says Greenberg. "Her endorsement is worth its weight in gold."

Some companies touched by Oprah got an instant lift that soon fizzled; others continue to enjoy the Oprah Effect to this day. For Greenberg, a link on Oprah.com prolonged the demand, generating 35,000 orders. The company now sells about 200,000 birds a year.

At **Eco-Bags**, which makes reusable grocery sacks, sales quadrupled, to $800,000, in the four months after the Ossining (N.Y.) company was featured on a 2007 episode dedicated to Earth Day. After the show, it expanded its online store to offer other green items Winfrey endorsed, helping boost sales for a year and a half. The Oprah nod helped the company land a deal to make bags for **Estée Lauder**. "We had people calling up just saying, 'I want to go green,'" recalls founder Sharon Rowe, who suddenly was able to afford solar panels for her house and her son's college bills. "Oprah made green cool."

The story was different for John and Terri Stephen after their call in January 2001. The show wanted their Weemote, a child-friendly TV controller, for an episode on tech breakthroughs. The device had hit the market only nine months earlier, selling through catalogs and a few specialty stores. The Stephens had three employees, including themselves, and shipped from the garage of their Palmetto Bay (Fla.) home. A few weeks later they got their 49 seconds of fame, and "we just stood there screaming," Terri says. "It was like the Super Bowl." Their website traffic surged eightfold, and people told them they'd made it.

$81 THOUSAND

Cost to buy one each of the "favorite things" on Oprah's show, 2002-2010

Not quite. They sold about 5,000 units online in the next three months, up from the couple hundred they normally sold that time of year. In the fall they sold 60,000 units to **Target**, but by then the attention had passed. "If we had it at retail, it would have given us so much lift we probably would have done quite well for a long, long time," says John. "It was a bit disappointing. You can't tell Oprah to wait." —*Matt Townsend*

The bottom line *Landing a spot on Oprah's Favorite Things show is every small company's dream. The inevitable sales bump could be difficult to manage.*

SAFETY

More than 420,000 people have signed Oprah's pledge to stop distracted driving

BLOOMBERG (2); CORBIS; GETTY IMAGES (2)

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Oprah's Wide Reach

From politics to products, a mention by the Queen of Talk can nudge a growing trend or start a new one —*Karen Weise*





HOMETOWN
Jerry Roper, head of the Chicagoland Chamber of Commerce, said the end of Oprah's show will cost the city "tens of millions, every year"



EDUCATION
Oprah's personal foundation, which focuses on education in the U.S. and women and girls in Africa, has over $235 million in assets



SPANX
The young company sold 50,000 pairs of footless pantyhose in three months after getting the Oprah nod in 2000



KFC
When Oprah and KFC offered free grilled chicken meals, customers downloaded 10.2 million coupons, overwhelming local stores

TECH
Pre-orders for Microsoft Kinect jumped 42 percent on Amazon.com after Oprah demoed the video game system

MEDIA
Oprah accounted for almost half of King World's $210 million in 1999 revenue



MAGAZINE
O, The Oprah Magazine had a hefty 905 pages of advertising in its first six issues in 2000-2001

CUPCAKES
After Oprah mentioned Sprinkles Cupcakes on her show, sales jumped 50 percent, to 1,500 cupcakes a day



BEEF
The day after Oprah's show about mad cow disease, cattle futures fell 10 percent

THEATER
Oprah's production of *The Color Purple* musical grossed over $100 million during its two-year run on Broadway

ANGELS
Oprah fans donated more than $80 million to Oprah's Angel Network, a grant-making nonprofit



TOM CRUISE
Viacom Chairman Sumner Redstone said Cruise's couch-jumping cost *Mission: Impossible III* $100 million in lost revenue



BOOKS
Oprah's Book Club picks averaged more than a million copies each from 1996 to 2002

The Next Act

Is Cable One Market Oprah Can't Conquer?

▸ The OWN Network—sans its namesake—gets off to a slow start

▸ "When you put the Oprah name on a channel, you expect to see Oprah"

As the rich and powerful–from Tom Hanks to Barack and Michelle Obama–lined up in May to tape the final episodes of *The Oprah Winfrey Show*, the door was swinging the other way at OWN, Winfrey's five-month-old cable channel. On May 6, Chief Executive Officer Christina Norman departed in the wake of disappointing ratings and growing losses, becoming the second top executive to leave the Oprah Winfrey Network.

For Winfrey, whose self-help empire includes film production, a hit magazine, and a book club that transformed publishing, cable television may pose her biggest challenge yet. Since its heavily promoted first week, the network's average viewership has fallen from 204,000 to 153,000 people as of May 15, according to Nielsen data. In the lucrative prime-time market, OWN draws an average of just 112,000 viewers in its target audience of 25- to 54-year-old women–less than half those who tune in to **Discovery Communications**' female-skewed channel TLC.

"The ratings have been below our expectations," concedes David M. Zaslav, CEO of Discovery, which owns half of OWN. One result: The channel will lose more than $122 million through 2012, estimates SNL Kagan analyst Derek Baine. That's far from the break-even Zaslav had predicted for this year just five months ago. In its search to find hit shows able to stand out amid cable's clutter, the joint venture spent $216 million through Mar. 31 to launch the channel. That's double Discovery's initial estimates, and the company says it "expects to provide significant additional funding."

Oprah, the channel's biggest hope, has also become its largest challenge. Although Discovery executives trumpeted the power of Brand Oprah, the Queen of Talk has so far been mostly M.I.A. from the channel. While there's a behind-the-scenes series chronicling the final season of her broadcast show, Oprah's syndication contract restricts her from having a talk show on cable before 2012. Instead, OWN fills much of

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its airtime with *Dr. Phil* reruns, fashion makeover shows, and reality fare similar to what viewers can find elsewhere. "When you put the Oprah name on a channel, you expect to see Oprah," says David Scardino, who advises clients on entertainment expenditures for ad agency RPA. Winfrey did not respond to requests for comment.

Winfrey will start to pop up more often on OWN after her talk show ends on May 25. In September, her broadcast contract will allow OWN to begin airing vintage Oprah episodes. The channel will air 60 with new intros taped by Oprah herself. In January, Winfrey will start a new show, *Oprah's Next Chapter*, although so far she's committed to appear in no more than three programs a week. In all, Oprah is required to appear on air for 70 hours annually, twice as many as she initially planned.

25%

Decline in OWN's average viewership after its much-hyped debut week

"She's an icon, and some of her fans will follow," says Bill Carroll, vice-president of Katz Media Group, which advises



TV stations. "The problem is, I can't tell you how many will find it. OWN is on channel 140 on a lot of cable systems."

Oprah has helped promote OWN. Singer Shania Twain appeared on Oprah's daytime show to plug *Why Not? With Shania Twain*, which premiered three nights later to some of OWN's best audience numbers. Winfrey's talk show also promoted *The Judds*, a reality show about the country singers, and *Becoming Chaz*, a documentary of Sonny and Cher's daughter's sex-change odyssey. Keeping up the momentum without Oprah's plugs is a challenge: Ratings for the second installment of Twain's show fell by 35 percent, OWN says.

OWN's overall ratings are below those promised to advertisers, says a person familiar with the numbers. Blue-chip advertisers, some personally pitched by Oprah, include **General Motors**, **Kohl's**, and **Procter & Gamble**, which reports have said signed a three-year, $100 million deal. Analysts say OWN needs higher fees from cable companies and satellite operators, many of whom have refused to increase the 7¢-per-subscriber they paid monthly to carry Discovery Health, the channel OWN replaced on their systems.

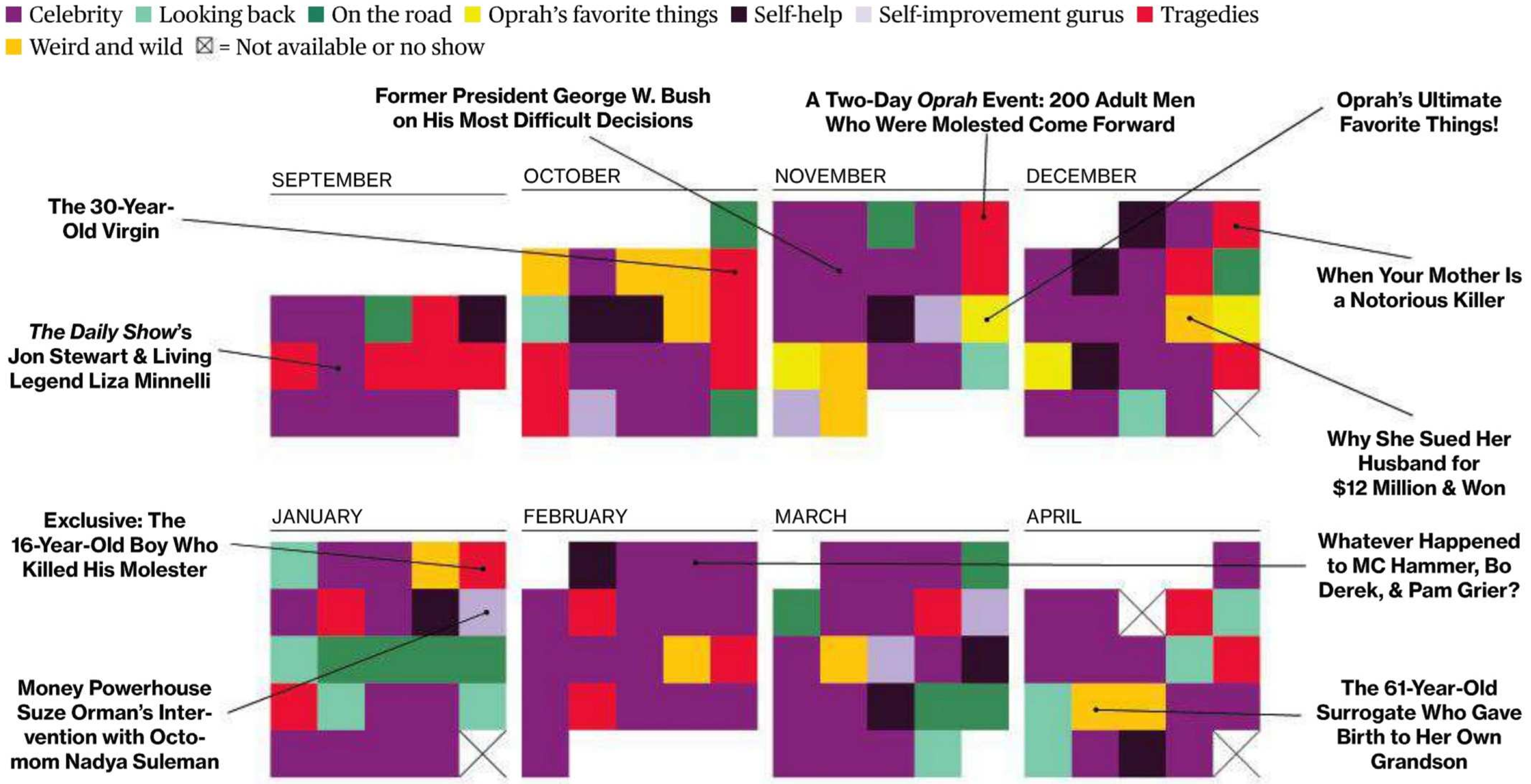
"They have all the bones in place to be extraordinarily successful," says Tony Vinciquerra, former chairman of Fox Networks Group. "The one issue is getting a big enough increase to support the programming necessary to pull it all together."

OWN is likely to get a boost when Rosie O'Donnell's talk show premiers this fall. Still, if a hefty dose of Oprah is what it will take to help OWN exploit its potential, Discovery executives were likely reaching for the Maalox when Oprah told the *Chicago Tribune* on May 9 that she had just met in New York with Broadway producers and could hit the stage soon. "I have a stack of plays in my bag right now that I am reading," she told her hometown paper. "Yes, this is really going to happen. Life is too short." **B**

—Ronald Grover and Andy Fixmer

The bottom line *Although ratings for Oprah's final syndicated shows are soaring, her new OWN cable network has drawn fewer viewers than expected.*

Oprah's 25th Season Dissected *by Kenton Powell*



DATA: OPRAH.COM; FREDERICK M. BROWN/GETTY IMAGES

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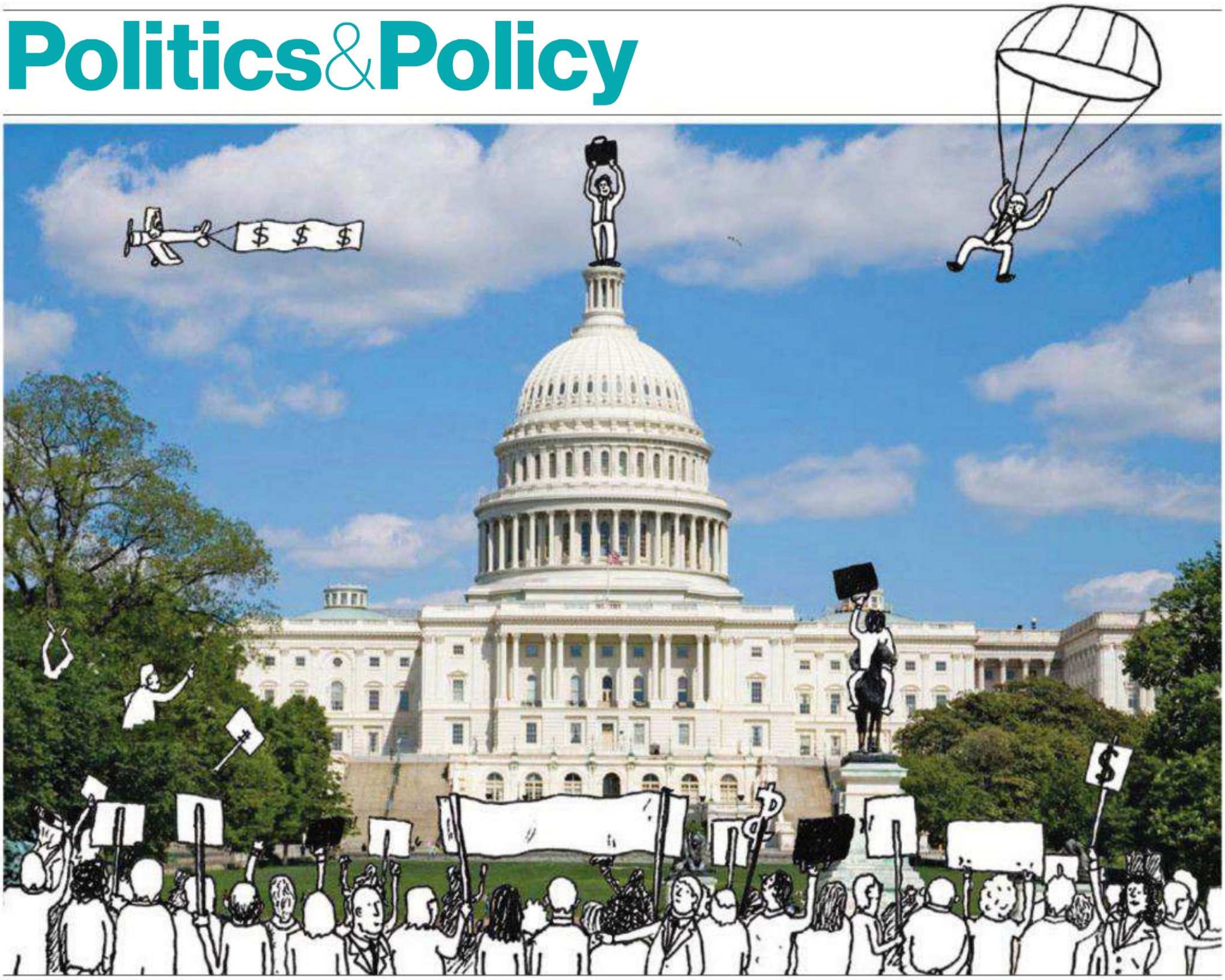
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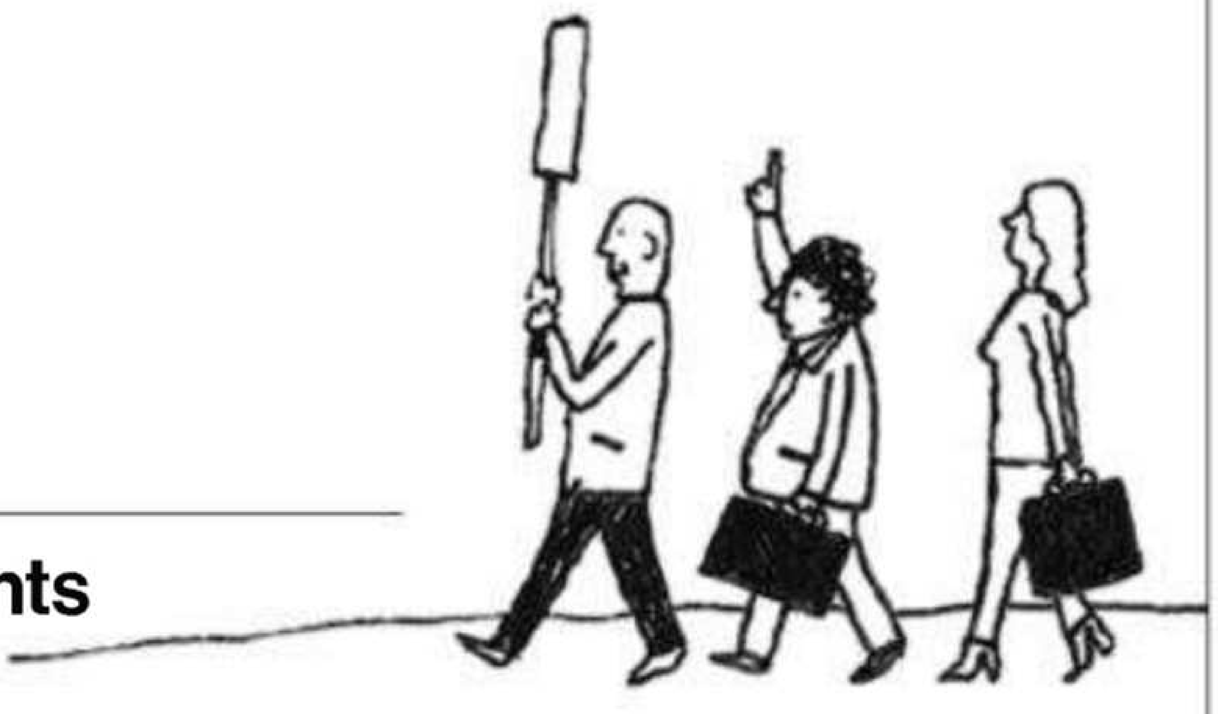

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▶ Canada's new crop of Millennial MPs 32 ▶ A Texas-size bet on Formula 1 racing 34 ● Edited by Cristina Lindblad

Politics&Policy



No Tax Break Too Small



▶ **As budget talks ramp up, lobbyists are out to protect their clients**

▶ **"I can't remember anything close to this"**

U.S. lawmakers in both parties are seriously weighing proposals that could shave from $4 trillion to $6 trillion from the U.S. budget over the next decade. For America's lobbying class, that's the equivalent of a Category 5 storm warning. So the pinstripe brigade representing interest groups as diverse as ethanol producers, defense contractors, and hospital chains has descended on the nation's capital in recent weeks to ensure their tax breaks and subsidies are spared. Some 2,000 real estate agents parachuted into Washington the week of May 8 to defend the tax deduction homeowners receive on mortgage interest. Thousands of farmers who want to forestall cuts in agriculture subsidies have also been buttonholing their representatives. "I can't remember anything close to this," says Howard Marlowe, president of the American League of Lobbyists in Alexandria, Va., who during three decades as a Washington lobbyist has seen his share of budget battles.

One lobbyist making the rounds is Bob Livingston. He represents **Raytheon** and **Northrop Grumman,** two defense contractors that have raised their deflector shields hoping to repel cuts to defense programs dear to them.

In Livingston's earlier incarnation as chairman of the House Appropriations Committee, the Louisiana Republican helped negotiate the landmark bipartisan budget agreement of 1997. That deal aimed to cut $204 billion over five years and was negotiated when the national debt was $5.4 trillion. Today, America's tab is approaching the statutory limit of $14.3 trillion, putting

ILLUSTRATIONS BY HARRY MALT/DEBUT ART; PHOTOGRAPH: TIM GRAHAM/THE IMAGE BANK/GETTY IMAGES

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With as much as $6 trillion in government spending on the line, interest groups are swarming Capitol Hill

the U.S. at risk of default. "The earlier debate didn't have nearly the same impact as the discussion today," says Livingston. "The difference is the magnitude of the problem."

Linked to a vote to raise the debt limit, negotiations on a bipartisan budget pact are getting started between Republicans who want to overhaul Medicare and Medicaid while cutting hundreds of programs and an Administration seeking smaller spending cuts and tax increases. At the same time, the bipartisan "Gang of Six" senators is trying to craft an overarching debt reduction proposal, even after one member—Senator Tom Coburn (R-Okla.)—quit the group on May 17.

While a final deficit reduction plan may be months away, Washington's lobbying horde is wasting no time. Growth Energy, a group representing ethanol producers, is battling proposals to end the 45¢-a-gallon tax credit for makers of the fuel, which last year cost the government about $6 billion. If the program is cut, ethanol producers have a fallback position: They want a new tax break to encourage use of vehicles that operate on corn-based fuel and the so-called flex-fuel pumps they need. "We can't have that go away until we have another form of access in the market," says Chris Thorne, a spokesman for Growth Energy.

The Service Employees International Union opposes cuts to Medicare and Medicaid, which would affect about 1.1 million nurses and other health-care workers the union represents. Union members visited lawmakers' home-state offices during the April recess, and five SEIU lobbyists have been meeting with legislators in Washington to urge them to raise taxes to close the budget gap. "We think that rich folks and American corporations have gotten off too easily in some of these proposals," says Peter Colavito, the SEIU's director of government relations.

Some lawmakers favor scaling back agriculture subsidies at a time when crop prices are high. The House passed a Republican budget that would cut $30 billion from agriculture programs over a decade. Farmers say they've already endured billions of dollars' worth of cuts to farm programs and that the pain should be spread across additional industries. "We will give our proportionate share, but it's time for everybody else to cough up some money," says Chandler Goule, a National Farmers Union lobbyist.

Amid the uncertainty, some groups are taking a hands-off approach—at least for now. The U.S. Chamber of Commerce and the National Association of Manufacturers have drafted a letter to congressional leaders in both parties, urging them to raise the debt limit without suggesting specific budget-changing approaches. Businesses should refrain from fighting specific cuts because that complicates efforts to reach a budget deal, says R. Bruce Josten, the Chamber's executive vice-president: "If everybody in the business community starts saying, 'Yeah, raise the debt limit, but don't touch this and don't touch that, and don't do this and don't do that,' you'll never get to an outcome."

The Chamber's view stands in contrast to other business interests in Washington. After agreeing to $155 billion in Medicare and other cuts in last year's health-care law, the hospital industry opposes further reductions in what it gets from federal health entitlement programs. About 1,000 hospital executives in April pressed their case with lawmakers, and the group is drawing on its 25 registered lobbyists to help push back on such proposals as turning Medicaid into a block grant to states. "We've already made some serious sacrifice and stepped up to the plate," says Richard J. Pollack, executive vice-president of the American Hospital Assn.

For the American Petroleum Institute, the lobbying has already paid off. On May 17 the Senate blocked a measure that would have repealed $21 billion in oil and gas subsidies over 10 years. API Chief Executive Officer

Immigration

Send Us Your Educated Masses





President Barack Obama says the U.S. needs to overhaul its immigration policy to attract skilled workers who can boost the country's economic competitiveness. The U.S. already educates many of the world's best and brightest. The goal, say some immigration experts, should be to retain and attract more foreign talent. Canada and the U.K. already do better on that count. —*Karen Weise*

Percent of permanent resident visas granted on the basis of skills and employment

15% in the U.S.	45% in the U.K.
67% in Canada	68% in Australia

Percent of U.S. population that is foreign born, by level of education

15% bachelor's degree holders	15% master's degree holders
17% professional degree holders	24% doctoral degree holders

SOURCE: MIGRATION POLICY INSTITUTE; U.K., AUSTRALIAN, AND CANADIAN IMMIGRATION AGENCIES; U.S. CENSUS. *EDUCATION DATA REPRESENT POPULATION AT LEAST 25 YEARS OLD

Jack N. Gerard, who met with legislators in advance of the vote, said of the legislation: "It's not consistent with what we need to create American jobs and produce American energy."
—*Laura Litvan*

The bottom line *Nurses, farmers, defense contractors, and others are fighting to protect tax breaks and programs dear to them.*

Health Care

Family Planning Takes a Hit in the Budget Brawl



TED MORRISON/BRAND X/GETTY IMAGES

▶ Republican-controlled states are cutting funding for clinics

▶ "If you're trying to make a budget argument, you lose out"

As the city-run Women's Health and Family Planning Center in Bayonne, N.J., closed its doors last month for the final time, workers hauled away desks, cabinets, and dozens of white boxes labeled "pregnancy tests" and "condoms." The clinic was one of six forced to close after Republican Governor Chris Christie eliminated all of the $7.45 million in state funding for family planning last year as part of an effort to narrow a budget shortfall approaching $11 billion.

While the governor opposes abortion, the decision to cut funding for clinics such as the one in Bayonne—which never performed the procedure—was motivated by economics, not politics, said Christie spokesman Michael Drewniak in an e-mail. "This is about the budget, making the hard choices and responsible spending."

Republicans, energized by the November elections that gave them control of 29 governorships, this year have introduced a record 570 bills in state legislatures that seek to restrict access to abortion, according to the Guttmacher Institute, a New York research organization that compiles reproductive health data. They are also cutting services that provide gynecological care, sex education, and contraception to primarily to poor women.

Elizabeth Nash, a policy analyst at Guttmacher, thinks politicians are being shortsighted. "If you're trying to make a budgetary argument, you lose out, because family planning saves money," she says. For every dollar spent on family planning, states save an average of $3.74 on maternity and infant care, according to a 2008 study by her organization. Family planning centers are the main source of health care for 60 percent of the women who use them, according to Guttmacher. Women who lose access to these clinics may be forced to seek care through hospital emergency rooms, boosting costs for states.

A proposal to strip all funding from Planned Parenthood, which received $363 million in government grants or contracts in 2009, almost shut down the U.S. government during budget negotiations in April. Although the measure was ultimately defeated in the Senate, attacks have continued on the state level.

On May 10, Indiana Governor Mitch Daniels signed a bill eliminating all state funding to organizations that provide family planning and abortions, which last year amounted to $1.4 million. The law also places some of the heaviest restrictions on access to abortion of any state. Wisconsin Governor Scott Walker's proposed two-year budget would cut about $3.8 million for family planning. In Minnesota, the Republican-controlled Senate is trying to do away with all funding for family planning as part of an effort to close a $5 billion budget shortfall. "Republicans for the most part are against abortion, so right away we said, 'Let's look at this,'" says Brad Biers, an administrator at the Minnesota Senate's Health and Human Services Committee.

570

State bills introduced in 2011 seeking to restrict access to abortion

Cutting funds for family planning won't prevent abortions, says Bill Albert, chief program officer at the

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National Campaign to Prevent Teen and Unplanned Pregnancy, a nonprofit group in Washington. Nearly half of U.S. pregnancies are unintended, according to the federal Centers for Disease Control and Prevention. "If you reduce the number of unplanned pregnancies, you reduce the number of abortions," says Albert. "It's a very simple calculation."

In Texas, the GOP-controlled House of Representatives on Apr. 3 passed a budget that cut more than $61 million for family planning. The bill is in a conference committee and must be signed by Governor Rick Perry, also a Republican. Janet Realini, a doctor and president of Healthy Futures of Texas, a San Antonio organization that works to reduce teen and unplanned pregnancies, says the reduction in funding would result in more than 20,000 additional Medicaid-paid births.

State representative Jodie Laubenberg, a Republican from Rockwall, Tex., believes limiting access to birth control will "not necessarily" increase unintended pregnancies. Says Laubenberg: "Sometimes when you have to pay for something, whether it's $5 or, on a sliding scale, even $30, you tend to take a little bit more responsibility for things, if you've got some skin in the game, excuse the pun." *—Esmé E. Deprez*

The bottom line *Republican-controlled states are restricting funds for family planning services, a move that may not save money in the long run.*

Elections

The Millennial MPs Descend on Ottawa

▶ An opposition upset has swept a crop of youngsters into office

▶ "To be honest, I agreed to run as a favor to the party"

If Laurin Liu could run the country, she'd fight to lower college costs. As a member of Canada's Parliament, that's what she plans to do. "Tuition should be accessible," says Liu, 20, who pays C$2,067.90 ($2,130) a year to attend Montreal's McGill University. Now she's putting her education on hold to make $157,731 a year as a rookie politician in Ottawa. She'll be joined by three fellow students from her campus political club, in addition to a McGill doctoral student, all of whom campaigned under the banner of Canada's New Democratic Party in May 2 elections. "To be honest, I agreed to run as a favor to the party," says Liu. "I didn't expect to win."

Meet Parliament's Freshman Class

Here are some of the young Canadians getting lessons in applied politics


CATHERINE PORTER/TORONTO STAR(2)

Much has been made of the comfortable majority Conservative Prime Minister Stephen Harper will enjoy when Canada's new Parliament convenes on June 2. Yet the election also produced big gains for the NDP, which captured 103 seats, up from 36. The result may be the youngest and most eccentric official opposition in the country's history. Along with the so-called McGill Five, voters elected an NDP slate that includes a 19-year-old political science student from another university and a bartender who spent part of the six-week campaign in Las Vegas. Some of the newbie politicians have barely set foot in the districts they represent. Liu, for one, spent most of her time stumping for another NDP candidate and only learned of her victory via a text message from a friend on election night.

The phenomenon that is the McGill Five reflects the quirks of the Canadian electoral system. Citizens don't vote directly for Prime Minister. They vote for the party candidate at the local level, and the leader whose party wins the most seats in Parliament forms the government. In districts—or ridings, as they are called in Canada—where a party has had no success in the past, a marginal candidate can get elected in an upset, riding the wave of support for a national party. That's what happened in Québec, where the NDP swept up 59 federal seats, up from just one. "They're called pylons, traffic cones you put in place to fill out the party roster," says John Duffy, a policy consultant at StrategyCorp in Toronto. "There's no landslide big enough to have complete nonentities get into the picnic in the United States."

It didn't help, of course, that a no-confidence vote suddenly toppled Harper's minority government in late


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Russia's Yandex: A $1 billion IPO page 39 ▶

March, leaving Canada's 18 federal political parties scrambling to assemble a full slate of candidates for all the 308 seats in the House of Commons. NDP officials say they're thrilled with their new crop of fresh-faced MPs. "Canadians are too often represented by lawyers and businessmen," says Kathleen Monk, a spokesperson for NDP Leader Jack Layton.

Maybe so, but some might wonder how much these Millennial politicians will rally around an NDP agenda that's focused on protecting pensions and financial incentives for people to build so-called granny flats for their aging parents. Certainly that's not what's top of mind for Pierre-Luc Dusseault who, at 19, is the youngest MP ever elected. Like Liu, he wants to bring down the cost of postsecondary education by increasing federal transfer payments for that purpose. As for those who may say he's too young for the job, Dusseault counters that "the House of Commons is supposed to represent everyone."

For Dusseault, the new job means giving up his summer job at a golf course to hire a staff and finding a place to live in Ottawa. McGill's Charmaine Borg won't be able to spend her junior semester abroad in Mexico as she'd planned. Liu may get a driver's license to handle the commute.

With Harper's sizable majority, the freshman MPs may find their influence is limited. "Some may stay afloat and learn the craft," says Duffy. "Most will blow out to sea and remember this as the best job they ever had."

—Diane Brady, with Theophilos Argitis

The bottom line *The youngest members of Canada's New Democratic Party may find their agendas at odds with their party's.*

Budgets

Speed Demons Have Their Day in Texas

▶ **The state is paying $25 million to bring Formula 1 back to the U.S.**

▶ **"I'm not sure of the wisdom of using tax dollars to fund a racetrack"**

Texas, which is staring at an estimated $15 billion two-year deficit, plans to commit $250 million in state funds to promote Formula 1 auto racing over the next decade. The international racing series showcases the world's fastest cars—low-slung, sophisticated machines designed to rigorous specifications (hence the word "formula") that can clock speeds of more than 200 miles per hour. Although hugely popular across much of the globe, the sport never really caught on in the States, and F1 officials stopped holding races in the U.S. in 2007.

Undeterred, a group of Texas investors, including **Clear Channel Communications** co-founder B.J. "Red" McCombs, are building a 3.4-mile track in Austin to host F1 races. State Comptroller Susan Combs, a Republican, has agreed to pay $25 million a year to underwrite races through 2022. According to Allen Spelce, a spokesman for the comptroller's office, F1's inaugural race in Austin next year will spur $300 million in spending on hotels, restaurants, and entertainment, allowing the state to recoup its investment through higher tax revenues. "It is important that the state continue to generate new economic activity to ensure that Texas continues to grow," said Spelce in an e-mailed statement.

Combs's plan to subsidize what is widely seen as a rich man's sport has drawn fire. As many as 100,000 Texas teachers stand to lose their jobs because of spending cuts, according to Moak, Casey & Associates, an Austin-based education consultant. For $25 million a year, the state could pay more than 500 teachers the average Texas salary of $48,000. "I'm not sure of the wisdom of using tax dollars to fund a racetrack," says Ewa Siwak, 44, whose job teaching German at Bowie High School in Austin is being cut. State Senator Dan Patrick, a Houston Republican, is another critic: "I don't understand why 25 people in Austin could not put up $1 million each if they thought this was a good opportunity, instead of the state making a $25 million commitment."

Bernie Ecclestone, chief executive officer of Formula One Management, the London company that oversees the annual roster of 20 races from Monaco to Abu Dhabi, says carmakers affiliated with F1 such as **Fiat**'s **Ferrari Group**, **Renault**, and **Daimler**'s Mercedes, have been eager to stage a U.S. comeback. "We wanted to hold it in America all along, we just didn't have a home," says Ecclestone.

With 20 million Texans living within 250 miles of Austin and a growing F1 fan base in neighboring Mexico, track developer **Circuit of the Americas** is confident that it can make its $242 million investment pay off. The $25 million a year that Combs has committed will be used to pay part of the licensing fee to Formula One Management.

Michael Cramer, a former president of baseball's Texas Rangers and hockey's Dallas Stars who now runs the sports and media program at the University of Texas at Austin, is skeptical that the state will be able to make back the money. "It's a very high cost of entry," he says. "With places struggling, spending that much money on an essentially one-off event is tough to do." Ⓑ *—Darrell Preston and Aaron Kuriloff, with Alex Duff*

The bottom line *Texas has pledged $25 million a year to Formula 1. Critics say the money should go to education or other priorities.*



Ferrari and other F1 carmakers are keen to get back into the U.S.

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WorldMags

Contents ▶ A new wave of Apple alumni should be good for their ex-employer 39 ▶ Yandex, Russia's homegrown search engine, is going public 39
▶ Innovator Richard McCullough's paint-on screens and solar cells 42 ● Edited by Jim Aley and Barrett Sheridan

Technology

"Like having a venereal disease that's in remission"

4 The number of startups Nuance has acquired, after suing them first

"A lot of companies can't handle the pressure"

"I'm flabbergasted"

Nuance has acquired 43 companies in 11 years

"The best strategist at the entire company"

▶ Nuance plays legal hardball in the speech-recognition business

▶ "I've been on 55 boards...and been a CEO twice, but I've never heard of anything like this"

When rumors swirled on May 7 that **Apple** might acquire **Nuance Communications**, shares of the software company rose 10 percent to $22, within pennies of an all-time high. The assumption was that Steve Jobs gets what Steve Jobs wants.

A safe bet—unless you know Nuance Chief Executive Officer Paul Ricci. In speech-recognition technology, which Nuance dominates, the soft-spoken Ricci is considered every bit as powerful as Jobs. Since leaving **Xerox** to join the company in 2000, Ricci has bought 43 companies to build the largest independent maker of software that lets devices understand you as you dictate a memo to your laptop, say, or tell your smartphone to find the nearest sushi bar. "People had been knocking away at speech recognition since the 1960s," says Bill Janeway, a partner at **Warburg Pincus**, Nuance's largest shareholder. "Paul turned it into a billion-plus business that makes technology used by hundreds of millions of people."

Ricci's critics say he's lawsuit happy and uses strong-arm tactics to weaken innovative rivals so he can buy them on the cheap or put them out of business. Over the past decade, Nuance, based in Burlington, Mass., has sued eight companies over alleged patent infringements. It hasn't won any judgments and lost one. On at least four occasions, it purchased smaller companies it had sued. "Competing with Nuance is like having a venereal disease that's in remission," says Dave Grannan, CEO of **Vlingo**, a speech-recognition startup that's involved in five Ricci-related lawsuits. (Nuance has four suits against Vlingo; Vlingo has one against Nuance.) "We crush them whenever we go head-to-head with them. But just when you're thinking life is great—boom, there's a sore on your lip."

"People had been knocking away at speech recognition since the 1960s. Paul turned it into a billion-plus business"

Vlingo's adventures with Ricci began in 2008, soon after **Yahoo!** chose Vlingo software over Nuance. Three months later, Grannan learned from a *Boston Globe* reporter that Nuance had filed a patent suit—without contacting the company to discuss royalties. "It was clearly an effort to hurt our business," says Grannan, who expects to spend $15 million on legal fees. Nuance spokesperson Rebecca Paquette said neither Ricci nor the company would comment on specific lawsuits against Vlingo or others. "In these highly technical fields, many companies attempt to gain advantage by simply using

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Matt MacInnis
At Apple, 2002–2009
Sr. Manager of Education
Now
Founder and CEO of Inkling

Nuance's inventions rather than developing their own," she wrote in an e-mail. "We have a duty to our stockholders to preserve the value of the company and its assets."

By summer 2009, with Vlingo running out of cash, according to Grannan, Ricci approached him about an acquisition. On Sept. 21, they met in San Francisco for a 14-hour negotiation. No agreement. Two days later, Ricci surprised Grannan and Vlingo co-founder Mike Phillips by calling to offer two more alternatives. First, Ricci promised to pay them and co-founder John Nguyen $5 million each if they could persuade their board to sell at his price. If that failed, and the three execs agreed to jump ship to Nuance, he'd pay them the amount they would have received in an acquisition—plus another $5 million if they stayed with the company for two years. As Ricci talked over speakerphone, Grannan says he looked at Phillips, mouthed "What the f---?", and asked Ricci to repeat. Ricci, who speaks in the measured tones of an academic, obliged. After notifying Vlingo's board of the offer, Grannan called Ricci back to express the board's displeasure. "I was flabbergasted," says Vlingo board member Bob Davoli. "I've been on 55 boards in my career and been a CEO twice—but I've never heard of anything like this."

Vlingo's board later accepted a $15 million investment in the company, after Ricci suggested that such a deal would align their interests and lead to a cessation of hostilities, says Davoli. "That was wishful thinking," he says. Rather than drop the lawsuits, Ricci stopped taking Grannan's phone calls. When Vlingo's board stopped admitting a Nuance-appointed director to its board meetings, Nuance sued for the right to attend.

In late 2006, Ricci took a run at a customer—**Tellme Networks**, which made an automated telephone-response system. Ricci had just purchased a company that made speech software used by Tellme. Mike McCue, Tellme's then-CEO, says he was contacted by Ricci, who declared he'd sue Tellme, introduce a competing product, and refuse to sell it more software unless Tellme's board agreed to sell to Nuance at Ricci's price. "It was an all-out attack on every front," says McCue, who now runs **Flipboard**, maker of a popular news app. McCue did sell the company in 2007—to **Microsoft**, for a far higher price. (Press reports had it at around $800 million.) A court later dismissed Nuance's patent claims as invalid. "We were able to outlast Nuance," says McCue. "But a lot of companies can't handle the pressure and give in. It's happened time and again." Ricci declined to comment on dealings with Tellme or Vlingo.

As Ricci talked on speakerphone, Grannan looked at Phillips and mouthed, "What the f---?"

Steve Tran, who co-founded **BeVocal**, a speech-recognition startup bought by Nuance in 2007, says he admires Ricci for his ability to understand the value of companies and his willingness to use all the tools at his disposal to obtain them at the right price. "Entrepreneurs can be a bit idealistic sometimes," says Tran. "We want to change the world. But he wants to build an empire."

An economist by training, Ricci began his career selling WordStar, one of the first word-processing applications. Then he joined Xerox's famed PARC research lab in Palo Alto, Calif., where he became known for tearing apart less quick-witted rivals in budget meetings. "He was the best strategist in the entire company—and he knew more about finances than the CFO," says former PARC director John Seely Brown.

When Ricci left Xerox to take over Nuance, then called ScanSoft, he correctly surmised that increasing computing power would make speech interfaces mainstream. In 2001, soon after speech-recognition pioneer Lernout & Hauspie went bankrupt after a massive accounting fraud, Ricci swooped in to buy the Belgium-based company for $39 million. Since then, Nuance has developed lucrative vertical businesses, including a healthcare division that makes automation software that lets doctors write prescriptions by



Lars Albright
2009–2011
Dir. of Publisher Partnerships
Now
Co-founder and CEO of Session M



voice. This division brought in 37 percent of the company's $332 million in sales last quarter.

Yet for all its market share and acquisitions, Nuance is coming under increasing pressure. The main reason is **Google**, which sees the things people say to their devices as a way to better target ads. Seven years after hiring former Nuance executive Mike Cohen, Google is giving away its speech recognition technology to the same phone makers and cellular carriers that buy from Nuance.



Kimon Tsinteris and Mike Matas
From Left:
2005–2010
Software Engineer
2005–2009
Human Interface Designer
Now
Co-founders of Push Pop Press

As for Apple, analysts say it's unlikely to buy Nuance. "Nuance has too many different businesses," says Gleacher & Co. analyst Brad Whitt. Jobs wouldn't want to continue licensing Nuance's technology to rival device-makers, Whitt says, much less muck around in the health-care industry. And yet people in this corner of tech can't help imagining what might happen should Jobs and Ricci meet across a conference table. Says Seely Brown: "I'd pay plenty to be in the room to hear that."
—*Peter Burrows*

The bottom line *Nuance's Paul Ricci built the dominant speech-recognition company with engineering, acquisitions—and a lot of lawsuits.*

YANDEX: HFP/ZUMA PRESS; NGUYEN: KIMIHIRO HOSHINO/AFP/GETTY IMAGES; DOLL: SANTA ROSA PRESS DEMOCRAT/ZUMA PRESS

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Matt Drance
2001–2009
Application Frameworks Evangelist
Now
Founder of Bookhouse Software



Evan Doll
2003-2009
Senior iPhone Software Engineer
Now
Co-founder of Flipboard



Chuck Goldman
2001–2009
Dir. of Enterprise Professional Services and System Engineering
Now
Founder and Chief Strategy Officer of Apperian



Bill Nguyen
2009–2010
Founder of Lala (startup bought by Apple)
Now
Founder of Color



Calin Pacurariu and Rainer Brodersen
From Left:
2004–2010
Product Line Manager
2001-2009
Application Engineering Director and Architect
Now
Co-founders of FitView

Startups

Apple Alumni Don't Fall Far from the Tree

▶ A wave of star engineers has left to start mobile app companies

▶ "We have left Apple but we ultimately still work for them"

After selling mobile ad startup Quattro Wireless to **Apple** in late 2009, Lars Albright took a job helping the iPhone maker work with its community of mobile app developers. He noticed that programmers were having trouble keeping users glued to their apps. *Voilà*: business opportunity. This spring he left Apple to start **Session M**. He won't elaborate other than that the startup has raised $6.5 million in venture capital and will help app makers build customer loyalty. Albright is one of a string of Apple managers and engineers who've quit to get a piece of the mobile app boom, a gold rush they helped create. Startups including photo-sharing app **Color**, tablet magazine **Flipboard**, and iPad textbook maker **Inkling** were all founded by Apple departees.

These alumni are using their Apple experience and relationships as a competitive edge. While building an iPad app for fitness trainers called FitView, former Apple engineers Calin Pacurariu and Rainer Brodersen ran into a bug. Unable to quickly fix the problem, Pacurariu sent a note to a former colleague. "Five seconds later, he said, 'Look at this, this, and this,' and sure enough, it was one of those three things," Pacurariu says.

Apple hasn't had a major exodus since the 1990s. Back then, "there was a pretty large list of people who left to go to companies like **Adobe** [and] **Logitech**, and people who were involved building the first generation of the Web," says Samir Arora, who left Apple in 1992 and went on to found Internet businesses **NetObjects** and **Glam Media**.

The stock's performance of late has given plenty of employees the means to do their own thing. And this time the departures may help Apple. "We have left Apple, but we ultimately still work for them because we're giving them 30 percent of everything we do on the App Store," says Mike Matas, who co-founded e-book company **Push Pop Press** in 2010 after four years at Apple. His company's first title was released on the App Store in April for $5. Apple takes about $1.50 of each sale. "Whether we're inside the company or outside, in a lot of ways the bottom line doesn't change for Apple," says Matas. Apple declined to comment.

Departees may also help their former employer break into new markets. Chuck Goldman ran Apple's technical outreach program to business customers until 2009. His Boston company, **Apperian**, charges **Cisco**, **Progressive**, and others up to $20,000 a month to build and manage iPhone and iPad apps for use by employees. An Apple rep accompanies Goldman on sales presentations to help him make the pitch. "You get more love from Apple when you help them," he says. "It's a quid pro quo relationship." —*Douglas MacMillan and Adam Satariano*

The bottom line *Apple's last exodus of talent was in the 1990s. This time, people are leaving to make apps—which may help their former employer.*

Search

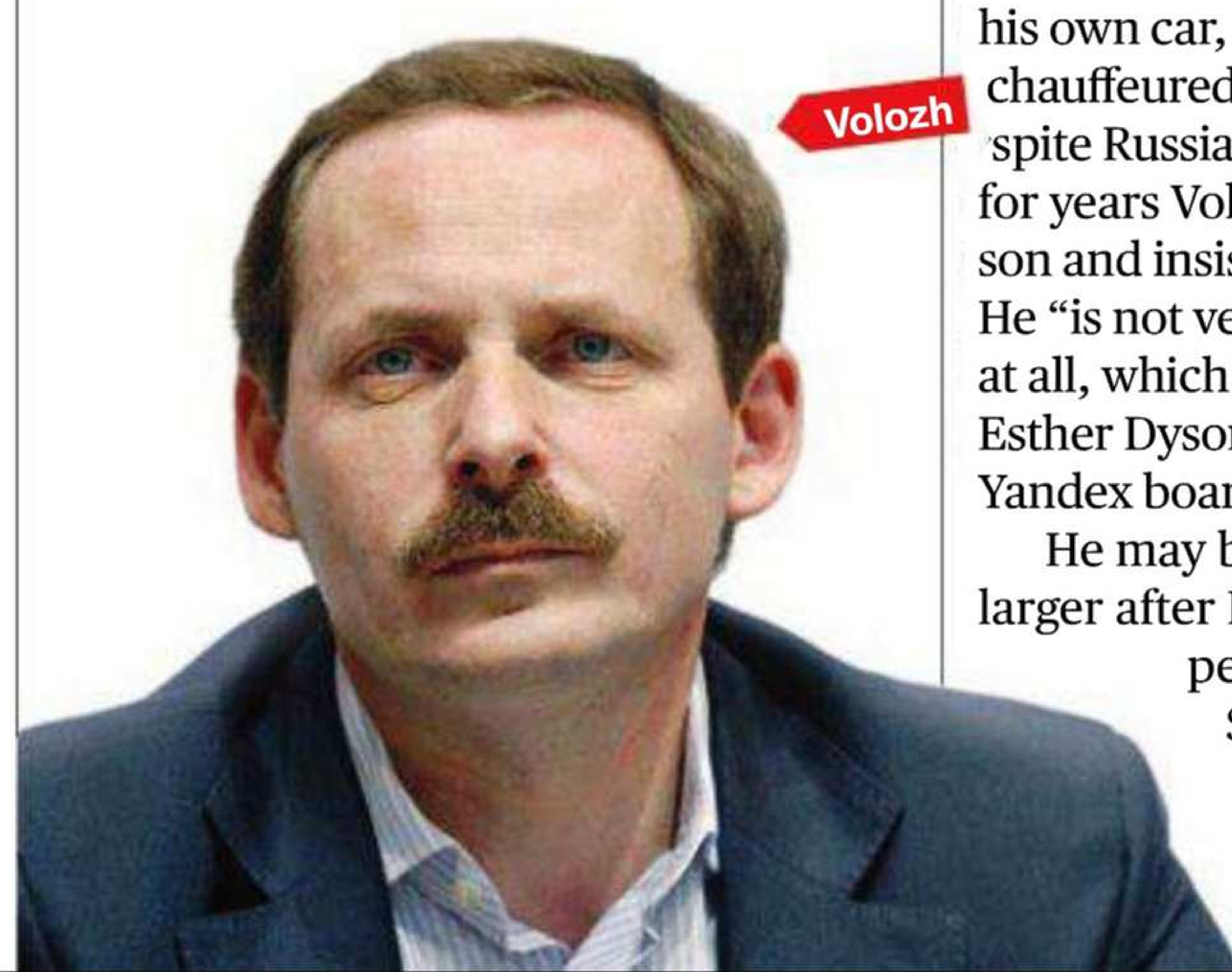
Saying *Nyet* to Google And *Da* to Nasdaq

▶ Russia's homegrown search engine is going public with a $1 billion IPO

▶ Yandex "has outpaced the big, brand-name Internet companies"

Arkady Volozh, the founder and chief executive officer of Russia's dominant search engine, **Yandex**, seems comfortable being the outsider. He's one of Moscow's wealthiest people yet still drives his own car, a Volvo SUV, in a city of chauffeured Bentleys and Maybachs. Despite Russia's penchant for nepotism, for years Volozh refused to hire his oldest son and insisted he find a job on his own. He "is not very ostentatious or grandiose at all, which is why he wears well," says Esther Dyson, a venture capitalist and Yandex board member.

He may be tempted to live a little larger after May 24, when Yandex is expected to raise around $1 billion in an ini-



Volozh

Technology

Betting on bankrupt companies page 47 ▶



tial public offering on **Nasdaq**. Most of Russia's successful companies are those that dig—for oil, nickel, aluminum. Others are tainted by accusations of corruption or intellectual-property theft. Yandex seems to be an exception: a homegrown market leader that leveraged Russia's math and engineering talent in pursuit of technological breakthroughs. According to research group LiveInternet, its search engine now accounts for 64 percent of the Russian market to **Google**'s 23 percent, and Yandex is hinting at ambitions abroad. For foreign investors, the question will be whether the Kremlin leaves the company alone.

Volozh and his high school friend, Ilya Segalovich, started working on search in the early 1990s. Their Internet search engine went live in 1997, and Yandex, which stands for "yet another indexer," became an independent company in 2000. Revenue has doubled every year since, and in the first quarter of this year, Yandex brought in $137 million, almost entirely from ads, according to its prospectus.

Part of the explanation for Yandex's success is first-mover advantage. Google didn't open a Russian office until 2005. Volozh and Segalovich began work on their indexing technology before Sergey Brin and Larry Page had even met, and they added maps, news search, and Web mail to Yandex's offerings years before Google did. Yandex "has outpaced the big, brand-name Internet companies," says Web pioneer Anton Nossik, who founded popular Russian news sites. It "did this by thinking about what was needed here, in the domestic market, and not what was already available."

Being native Russian speakers helps. Yandex's algorithm accounts for the intricacies of Russian grammar, where the same word can have dozens of different endings depending on its place in a sentence. It can, for instance, recognize the word "field" ("*polye*") even when it appears in a phrase like "lilies of the field" ("*polevye lilii*"). Google couldn't do the same until 2007.

Talk of a Yandex IPO first surfaced in the summer of 2008 but was stymied by the global economic crisis, when Yandex reported that ad revenues fell by more than 40 percent. Yandex executives would not comment for this story because of Securities and Exchange Commission rules requiring a quiet period before the IPO. In its prospectus, Yandex warns investors that "well-funded, well-connected financial groups" in Russia occasionally use "economic or political influence or government connections" to take over independent companies. "Our ability to thwart such efforts may be limited," the prospectus reads.

Yandex would know. In 2008, Alisher Usmanov—an Uzbek mining oligarch and longtime ally of Russian President Dmitry Medvedev—said he tried to buy a 10 percent stake in Yandex but was rebuffed. According to local press reports, the following year the Kremlin forced Yandex to sell a "golden share" to a state-owned bank for one euro. The share gave the bank, and by extension, the Kremlin, power to veto any acquisition by a foreigner of more than 25 percent.

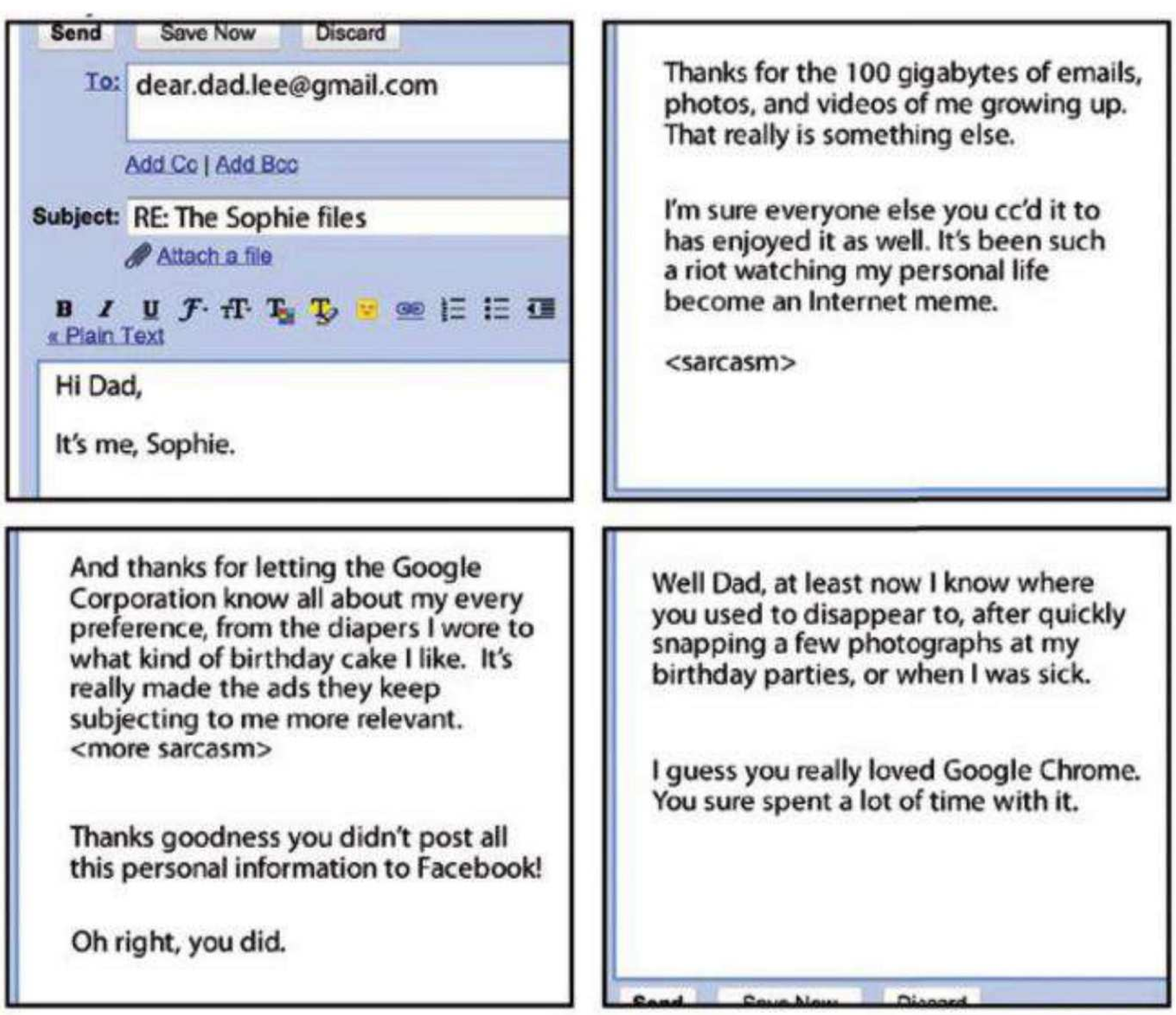
There was more Kremlin interference in 2009, when a video showing the beheading of a Russian soldier by rebels in the restive North Caucasus made it into Yandex's top blog search results. According to a top Yandex executive, the Kremlin's first deputy chief of staff, Vladislav Surkov, called Volozh to complain about the material because it was unpatriotic. Volozh replied that the search results were automatically generated. Surkov was not convinced, according to the same source, and forced Yandex to remove the blog rankings. Afterward, Surkov toyed with the idea of creating a "national" search engine controlled by the Kremlin, according to local press reports. Surkov's office did not respond to requests for comment. A Yandex executive interviewed in December 2009 says the company was slow to grasp the importance of lobbying but has begun to take it seriously; Volozh now meets regularly with Surkov.

Yandex says in its prospectus that some of its IPO funds will be used to expand internationally. Asaf Homossany, who heads Nasdaq's global markets, says it could be a new era for Russian enterprise. "We've passed the peak of these giant resource companies entering the global market," he says. Up next are the Russian tech companies. —*Julia Ioffe*

The bottom line *Yandex has stepped up its lobbying to cope with political pressures at home. Some of its IPO funds will be used for international expansion.*

DANIEL ACKER/BLOOMBERG

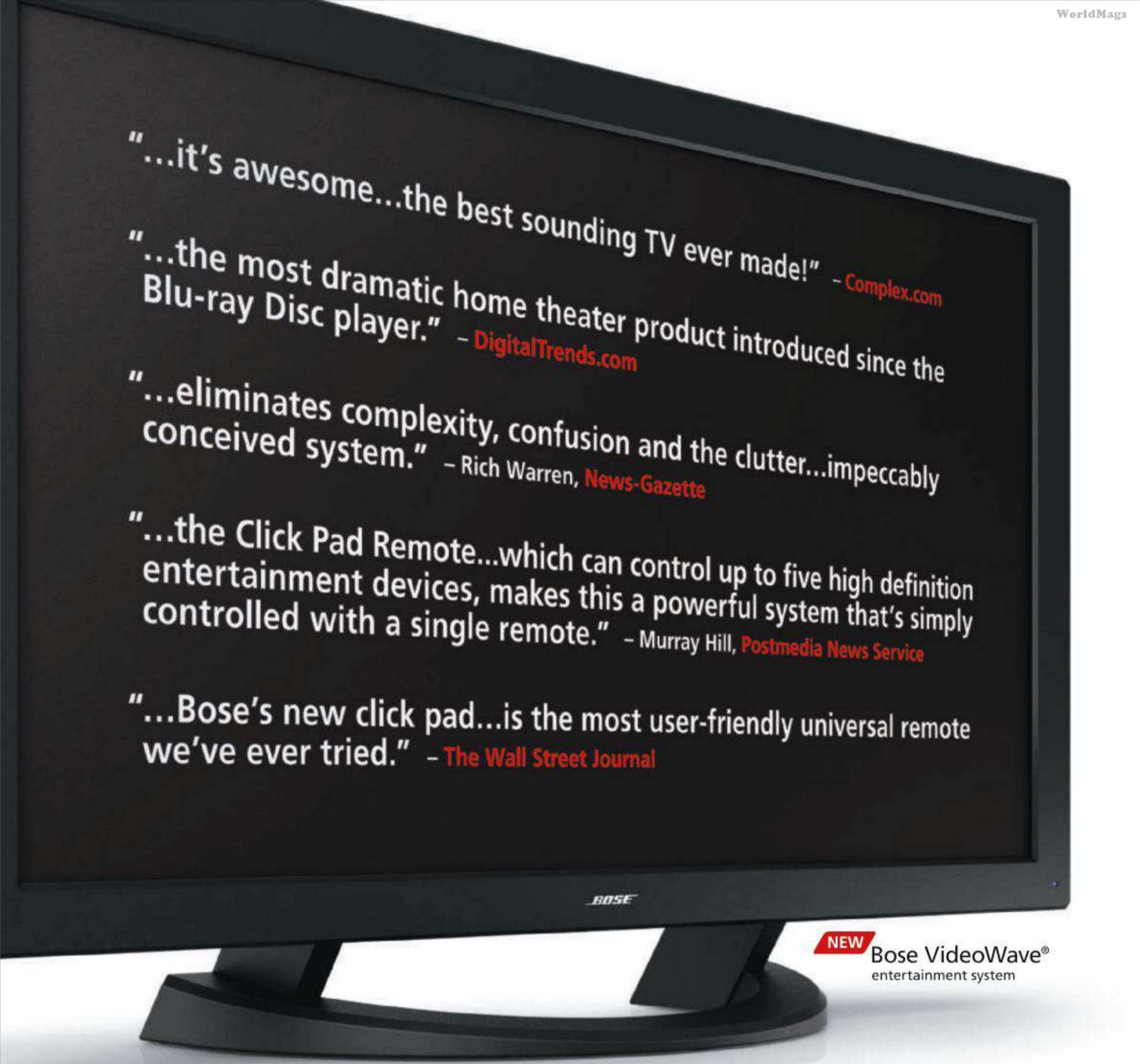
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Innovator

The Bendable Future



Carnegie Mellon Professor Richard McCullough has created a conductive "ink" that could lay the groundwork for thin, flexible phones and TVs

The screens that dominate our lives—smartphones, tablets, televisions—keep getting sleeker and sleeker. Richard D. McCullough, dean of the College of Science at Carnegie Mellon University in Pittsburgh, says that, soon enough, they'll be as thin as a coat of paint.

At Plextronics, where he is co-founder and chief scientist, McCullough is working to perfect conductive "ink." The ink is actually a polymer, or a synthesized chain of molecules, that can conduct electricity like metal while remaining flexible like rubber. It's a "disruptive technology that can be printed on anything," he says. A surface as thin as a magazine page, for instance, could become a bendable, foldable video player. "Imagine a Kindle or an iPad on steroids," says McCullough, 52, who earned his PhD in chemistry from Johns Hopkins University.

The technology builds off work that McCullough began in 1990, when he was an assistant professor of chemistry at Carnegie Mellon. After 10 years of federally funded research, he found a way to synthesize conductive polymers reliably and cheaply. He obtained a patent and recruited serial entrepreneur Andrew W. Hannah, who had worked at several early-stage technology companies, to help turn his ink into a business. They founded Plextronics in mid-2002, and Hannah, 45, took the job of chief executive officer.

Today the 65-person company manufactures McCullough's ink in its factory in Harmar Township, Pa., about 20 minutes outside Pittsburgh. The ink has many applications, and Raghu Das, CEO of research firm IDTechEx in Cambridge, Mass., says the market for printed and thin-film electronics will be $2.2 billion in 2011 and could reach $44.2 billion by 2021.

One of the first applications Plextronics is pursuing is in making better, cheaper, organic light-emitting diodes. OLEDs are essentially molecules in a layer that light up when electricity is applied. Unlike most of today's smartphone and TV display screens, which rely on liquid-crystal-display technology, OLEDs don't require backlighting, so they're far thinner and use less energy. McCullough says Plextronics's ink will be ready for smartphone screens within two or three years, and in larger displays a year or two after that.

OLEDs can also be used in conventional lighting fixtures. In late April, Plextronics announced its first distribution deal, with Sanyo Chemical Industries in Japan, which will market the ink for OLED lighting to major electronics companies. Plextronics is also developing a version of its ink for the solar industry. The company plans to start selling organic photovoltaic cells by 2012 and envisions their being used for indoor advertising, where they could power displays by harnessing energy from a store's overhead lighting—no batteries necessary.

Hannah says Plextronics had between $5 million and $10 million in revenue last year selling ink to manufacturers and researchers, and expects to do about the same this year. The company has raised a total of $55 million from investors, including Santa Clara (Calif.)-based Applied Materials and Solvay Chemicals in Brussels.

McCullough, who grew up in humble surroundings in Mesquite, Tex., and is the first member of his family to graduate from college, recognizes how far he's come. Growing up, "we were so poor we couldn't afford to get our oven fixed, so we cooked on a gas grill outside," he says. "Now I drive a Porsche Cayenne." B —*Karen A. Frenkel*


Background ▶ McCullough grew up poor in Mesquite, Tex., and is the first of his family to earn a college degree

Breakthrough ▶ A way to cheaply and reliably synthesize polymers that conduct electricity

Business ▶ Plextronics makes "inks" for paper-thin screens, lighting fixtures, and solar panels

HARRY GIGLIO VIA BLOOMBERG

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*Source: Over the 10-year period ending October 2010, gold's correlation with the S&P 500 has been -0.06, with 0 being uncorrelated and 1 being perfectly correlated (StyleADVISOR, December 2010).

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The Man Who Was Octopussy

▶ **Zvi Goffer is on trial in Chapter Two of the Galleon saga**

▶ **His tapes will likely "sound like a lot of *Sopranos* dialogue"**







In the weeks after FBI agents arrested him on insider-trading charges in November 2009, Zvi Goffer maintained his bravado. The government, he told former colleagues from **Galleon Group**, a manager of hedge funds, could not possibly have damning evidence against him.

One of those associates recalls asking Goffer if he'd been reading the papers and telling him that the feds seemed to be pretty serious. A sign that the FBI might have incriminating evidence was that weeks before Goffer's arrest, agents had detained Galleon's co-founder, Raj Rajaratnam, an alleged beneficiary of Goffer's insider tips. The investigation was a lot bigger than Goffer could admit to himself, says the former colleague, who worked with Goffer at Galleon. The ex-colleague, who has not been charged in the insider-trading investigation, spoke with *Bloomberg Businessweek* on the condition that he not be named.

The trial of Goffer, his brother Emanuel, and a third associate that got under way on May 16 marks the second round of intertwined cases tied to a nationwide insider-trading probe now unfolding in federal court in Manhattan. Opening arguments came only a week after Rajaratnam was convicted in the same courthouse of directing the biggest illegal stock-tipping ring since the 1980s. The connection between the two trials will become evident when prosecutors play undercover recordings of Rajaratnam in the Goffer case, U.S. District Judge Richard J. Sullivan has said. "Mr. Rajaratnam is going to be a factor in this trial," Sullivan told lawyers in a hearing before the start of jury selection.

Still, this won't feel like a replay of the Galleon chief's trial. Rajaratnam, 53, was a billionaire philanthropist with ties to other leading American businessmen and financiers of South Asian descent. Goffer, 34, operated in a more modest world of hedge fund hangers-on whose activities resemble those of day traders.

According to prosecutors, Goffer, who ran money for Rajaratnam at Galleon for about eight months in 2008 before starting his own firm, **Incremental Capital**, was referred to by some of his associates as "Octopussy." The James Bond movie allusion supposedly suggested Goffer's many tentacles reaching for confidential corporate information. His former colleague doesn't recall anyone using the nickname, however. While someone may have said "Octopussy" on an FBI wire, the nickname wasn't heard around the office, he says.

Goffer was a popular, rough-around-the-edges young man whose father drove a New York City cab for 30 years, the former colleague says. At Galleon, Goffer's role wasn't entirely clear to some of his co-workers. He hung around with the secretaries and chatted about popular TV shows such as *The Bachelor*, the former colleague says. ➜

◀ Prosecutors say Goffer fed tips to Galleon's Rajaratnam



Over time, though, it became apparent that Rajaratnam believed Goffer had valuable stock tips.

Goffer and two Incremental colleagues—his brother Emanuel, 32, whom everyone called "Nu," and Michael A. Kimelman, 40—are charged with conspiracy and securities fraud. Manhattan U.S. Attorney Preet Bharara has charged 14 people as members of the Goffer ring. Ten have pleaded guilty, and one remains a fugitive.

Prosecutors allege that Zvi Goffer paid tens of thousands of dollars to two attorneys with the corporate law firm Ropes & Gray for information on pending takeovers the firm was handling. The lawyers have pleaded guilty to securities fraud, and at least one is expected to testify for the government. Goffer's sources passed along tips on acquisitions of companies including **3Com**, **Axcan Pharma**, **Kronos Worldwide**, and **Hilton Hotels**, according to prosecutors. The group netted at least $20 million, the Securities and Exchange Commission has alleged in a related civil lawsuit.

All three men have denied wrongdoing. William R. Barzee, Zvi Goffer's lawyer, said in his opening statement to jurors on May 18 that his client "was like one of those gold prospectors with a tin pan searching for gold in a river, and the river was the stream of information and gossip blogs." Barzee called Goffer a "braggart" who exaggerated what he knew.

Like many young traders, Zvi Goffer seemed like he was in a big hurry to make a lot of money, his former colleague says. He bought expensive seats at Knicks basketball games and invited friends to Madison Square Garden.

After his arrest, Goffer repeatedly declared that he wouldn't turn on Rajaratnam and provide the FBI with incriminating information. He was not a "rat," he told his former colleague and others.

In one call recorded by the FBI, Goffer told an associate, "We have become so paranoid for no reason," according to a government summary of the wiretaps. In another, he cautioned a codefendant who has since pleaded guilty: "Someone's going to jail, going directly to jail, so don't let it be you, O.K.?"

The tough talk on tape may distinguish the Goffer trial from the Rajaratnam case, in which the defendant's lawyer argued that his client relied on analysts' reports and other legitimate information as the basis of trades. The Goffer tapes are likely to "sound a lot like *Sopranos* dialogue," says Anthony Sabino, a professor at the Peter J. Tobin College of Business at St. John's University in New York. "Any juror who watches a lot of TV will know that they sound more like gangsters committing crimes than real traders." *—Paul M. Barrett, with Patricia Hurtado and Bob Van Voris*

The bottom line *The alleged Goffer insider-trading ring netted profits of $20 million, according to a civil lawsuit filed by the SEC.*

7.19

PERCENT

The average yield on speculative grade bonds on May 16, a record low, according to Bank of America Merrill Lynch's U.S. High Yield Master II index.

DATA: BANK OF AMERICA MERRILL LYNCH

Real Estate

Home Sellers Provide Last-Resort Loans

- A risky tactic when conventional mortgages are not an option
- "They're hoping everything will work out. ... It's an act of faith"

Sue and Douglas Reed knew no bank would give them a mortgage—not with a bankruptcy and two foreclosures fresh in their credit history. They turned to Hilarie Walters, whose childhood home on 15 acres in Marshall, Mich., had been on the market since 2009, a year after she inherited it. Walters agreed in December to sell the property to the Reeds for $105,000. She also consented to a risky payment plan that in effect makes her the couple's mortgage lender. "They're paying me interest every month, but I'd rather have the money and be done with it," says Walters, an unemployed single mother who is using their payments to cover the mortgage on her Battle Creek (Mich.) residence. "It does make me nervous."

Financing provided by sellers, popular in the 1980s when mortgage rates reached 18 percent, is making a comeback in markets such as Michigan that have been hit hard by foreclosures and where tightening lending standards and years of economic distress have drained the pool of creditworthy buyers. For a small but growing number of people, it's the only way to get a deal done. "Anytime the market is in this much trouble, people have to find ways to get it to function," says



Offering financing is the only way for some sellers to get a deal done

Dennis Capozza, a professor of finance at the University of Michigan in Ann Arbor. Capozza has direct experience with seller financing: He purchased a friend's foreclosed home a couple of years ago and then allowed him to buy it back in installments.

Last year 52,991 U.S. homes were purchased with owner financing, up 56 percent from 2008, according to Realtors Property Resource, citing data collected from county record offices. Such deals accounted for 1.5 percent of all transactions in 2010. Michigan, which has a 10.3 percent unemployment rate, leads the nation with about 1,600 home listings that advertise seller financing, followed by Florida, Ohio, California, Wisconsin, Minnesota, and Texas, according to property website Trulia.

The risks in such deals are significant for both buyer and seller, says Jason P. Hoffman, a Faribault (Minn.) real estate attorney. "Each of them is seeking an advantage in an otherwise difficult situation, and they're hoping everything will work out as envisioned," Hoffman says. "It's an act of faith."

The Reeds, who put $25,000 down, make monthly payments of $565, reflecting a 7 percent interest rate, with the full balance due in five years. "This is the American dream, and we're going for it no matter what," says Sue, 56, who sells snacks from a trailer at estate auctions and going-out-of-business sales. "We'll either make it or it will break us."

The riskiest deals involve sellers who have bank loans on the properties, Hoffman says. Most mortgages contain a "due on sale clause," meaning the lender can call the loan if the home is transferred. While community banks sometimes grant exceptions, many homeowners take their chances, hoping lenders won't ask questions as long as the payments stream in, he says.

Some investors see seller financing as a marketing tool. Mark Cook, 30, a real estate agent in Lake City, Fla., says he sees an untapped market in people who have had their credit ruined by a foreclosure or short sale. Cook is working with a Canadian investor who bought and renovated four homes in Florida's Cape Coral and Fort Myers areas since September, selling them to buyers who needed financing. One more is for sale now, another is under renovation, and they have contracts to buy another handful of homes.

Cook markets homes to buyers with foreclosures in their credit history, as well as second-home purchasers and self-employed borrowers who don't show enough income on their tax returns to qualify for traditional financing, he says. He offers an interest rate of 9.95 percent and a balloon payment after seven years to buyers who can put down 20 percent in cash. "We are advertising in markets that are cheap, and we're satisfying the consumer's appetite for a bargain," Cook says. "Assuming you're not creditworthy and have cash, we are your avenue for buying a home."

1.5%

Percentage of home sales with owner financing in 2010

Rebecca Hill, a 33-year-old high school science teacher, and her fiancé, Nicholas Lehman, bought an almost 2,000-square-foot house in Cape Coral through Cook for $107,000 on May 4. Her credit was damaged a year ago when her ex-husband lost a home they had purchased together in foreclosure, according to Hill. While they paid a premium for a seller-financed home, the monthly mortgage costs are $175 less than the rent they previously paid for a unit half the size, she says. "If I wait for my credit to be restored and then purchase, I'm not going to get a $107,000 four-bedroom home," Hill says. "That's not going to exist anymore." —*Prashant Gopal*

The bottom line *In 2010, almost 53,000 homes were purchased in the U.S. with owner financing—sales that might not have happened otherwise.*

Investing

Why People Buy Stock In Bankrupt Companies

▶ Ignoring the odds and hoping for leftovers after the debts are paid

▶ "I still believe there is more to this shell," says an investor

Blockbuster's stock must be worth something, says Ron Krenn, a 48-year-old day trader in Daytona Beach, Fla., who hopes to profit on the equity of what was once the world's largest movie rental chain, seven months after it filed for Chapter 11. He's not alone. Since Sept. 23, the date of Blockbuster's bankruptcy, the stock price has ranged from 4¢ to 23¢, with volume averaging 5.46 million shares a day.

Krenn and others who buy stock in bankrupt companies such as Lehman Brothers, Washington Mutual, and Borders hope there will be money left over for equity holders after all the debt is repaid. It's an increasingly risky gamble. Bankruptcies are less likely than ever to return anything back to stockholders, according to a new study.

Once a company files for Chapter 11, creditors are paid first in order of their seniority, with shareholders coming last after senior lenders, unsecured creditors, and holders of preferred stock. Unless creditors are paid in full, shareholders get nothing. If the company reorganizes, any stock in the new company usually goes to creditors.



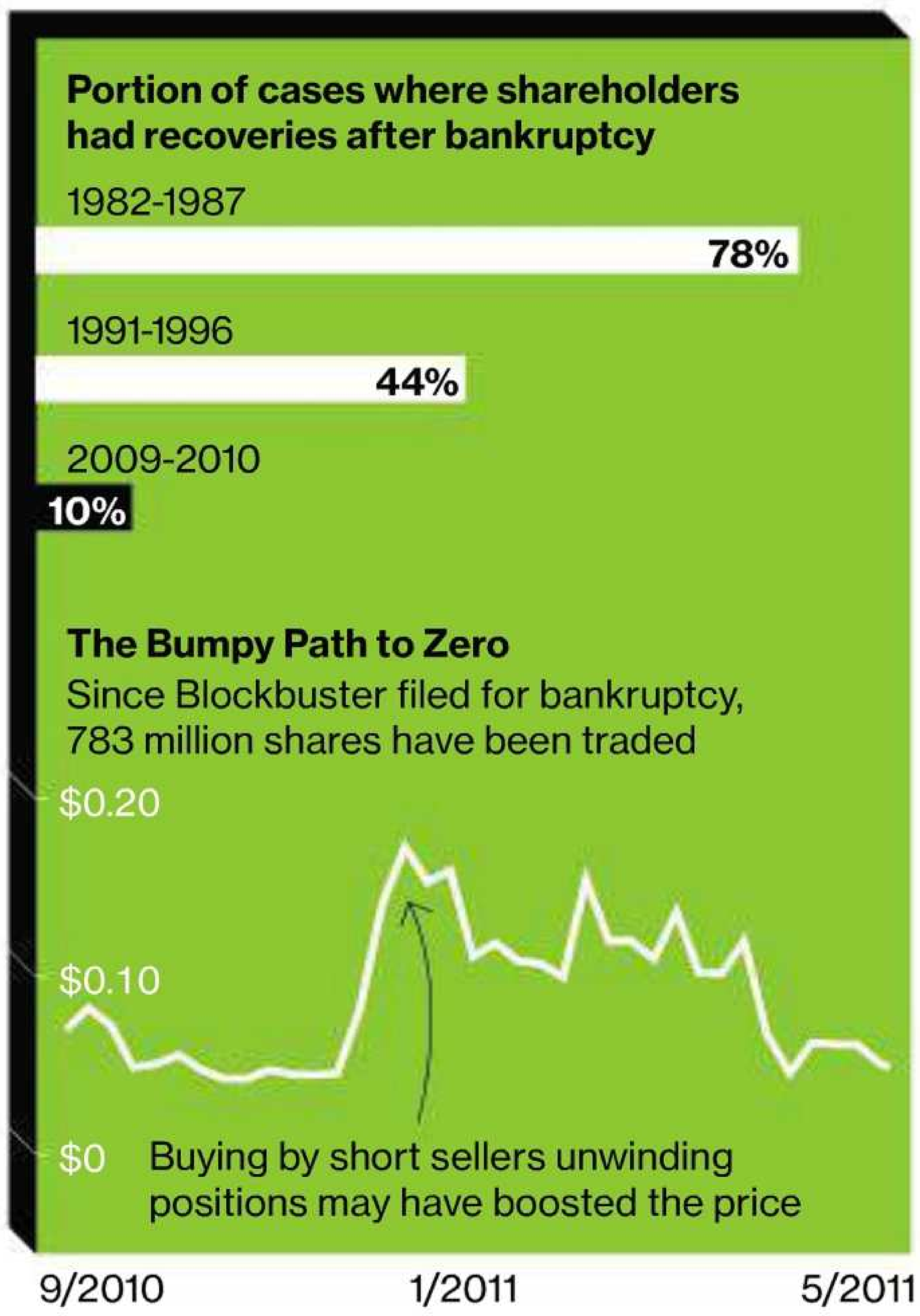
PREVIOUS PAGE: DANIEL ACKER/BLOOMBERG (3) DAVID J. PHILLIP/AP PHOTO; ILLUSTRATION BY GRAHAM ROUMIEU



The mystery man in the Galleon mess page 56 ►

Diminishing Returns

Payouts to shareholders of bankrupt companies have become increasingly rare



DATA: BLOOMBERG, ANDREW WOOD

Of 41 bankrupt public companies that announced reorganization plans in 2009 and 2010, only four delivered returns to shareholders, according to a study by Andrew Wood, a student at the UCLA School of Law who works with Lynn LoPucki, a UCLA bankruptcy law professor. Of the companies that went through bankruptcy from 1991 through 1996, 44 percent had returns for shareholders. The figure was 78 percent for those that went bankrupt from 1982 to 1987. "The number of cases in which equity makes more than a nominal recovery has steadily declined since approximately 1987," wrote Wood. The study cites an increase in the amount of secured debt carried by companies as one reason for the decline in shareholder recoveries. Wood also found a decline in recoveries for unsecured creditors.

Some speculators beat the odds. LoPucki cites the case of **Tronox**, a producer of titanium dioxide pigment, which gave shareholders 5 percent of the new stock when it reorganized. The shares trade near $130, up from $123 when the company emerged from bankruptcy on Feb. 15.

Stock investors don't get a final accounting until a bankrupt company files a disclosure statement, which details the terms of recovery for each class of creditor and announces whether existing shareholders get anything. Until then, the stock continues to trade as secured creditors and unsecured creditors fight over the company's worth and investigate potential lawsuits that could bring money into the bankrupt estate. Some investors bet on the stock, while those who sold it short—borrowing shares and selling them, hoping to buy them back later at a lower price—unwind their positions. Purchases by short sellers can sometimes lead to a temporary runup in price.

Blockbuster, which has yet to file a disclosure statement, said in a May 9 regulatory filing that it "anticipates" its A and B shares will be worth nothing. Krenn, who bought Blockbuster shares for 6¢ each in February, says he saw the company's regulatory filing, but dismissed it. "I still believe there is more to this shell," Krenn wrote in an e-mail on May 12, saying he was buying stock on the dips and awaiting news on the value of the company's Italian assets.

Some investors may trade on news about a bankrupt company without fully understanding it. Paul Rachmuth, a bankruptcy lawyer with Gersten Savage, represents Blockbuster shareholders. He says the sale of the company's assets to **Dish Network** for $320 million on Apr. 7 effectively ended the chance that shareholders would get any money. Nonetheless, from Apr. 6 to Apr. 8, the stock rose 17 percent, to almost 7¢ a share. As of May 16, it was trading at just above 5¢ a share, giving the presumably worthless stock a market value of $9.7 million.

Jon Becker, 53, who owns a grocery store in Miami Beach, bought a few thousand dollars' worth of Blockbuster at 10¢ a share in February. He was still holding the shares when Dish Network bought the company's assets. Becker says he did not realize that the stock could end up worthless. He can't believe there was nothing on his screen to differentiate Blockbuster from other stocks he buys on **E*Trade Financial**: "It's a different category than normal risk," he says. "If it's foreseeable shares would go to zero, I would think the powers that be would flash something—some kind of warning." Why did he buy a bankrupt stock in the first place? "My thought was, this is Blockbuster, it will come back," Becker says. It didn't. He finally sold at 7¢ a share. —*Tiffany Kary*

***The bottom line** Only 4 of 41 public companies that went through bankruptcy in 2009 and 2010 produced returns for shareholders.*

Quoted

"You just have to get used to lower levels of yields for a while."

—Bank of America Merrill Lynch interest rate strategist Priya Misra, saying that with the economy still anemic, the end of the Federal Reserve's bond buying program would not lead to higher interest rates.



GUPTA: RAMIN TALAIE/BLOOMBERG

Education Finance

Sallie Mae Makes a Surprising Comeback

▶ Shut out of its main business, the company targets private loans

▶ "They have this cash cow, which is the legacy portfolio"

The student loan company **SLM**, better known as Sallie Mae, has taken a thrashing in recent years. In 2007, Sallie Mae's stock fell from $58 to $19.65 a share in the wake of a failed buyout attempt led by private equity firm **J.C. Flowers**. Shares sank as low as $3.19 in March 2009 amid the financial crisis, which froze the debt markets it relies on for funding. Last year, Congress passed legislation that knocked private lenders out of the business of making government-backed student loans, which had accounted for 80 percent of Sallie Mae's lending.

Such blows would seem to add up to a dreary outlook for Sallie Mae and its chief executive officer and vice-chairman, Albert L. Lord. Yet investors are wagering the company will prosper on a combination of old loans and private lending. Sallie Mae's shares have jumped 29 percent in 2011, closing at $16.22 on May 16, compared with a 5.7 percent gain for the Standard & Poor's 500-stock index. On Apr. 21 the company raised its

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earnings estimates for the year and declared its first dividend since 2007.

Created in 1972 as a government-sponsored enterprise, Sallie Mae was fully privatized in 2004 and, until recently, made most of its money by issuing government-backed student loans. Competing with banks and other lenders, it dominated the market: In 2009 it accounted for more than one-third of the loans made through the Federal Family Education Loan Program. Under a law that took effect in March 2010, the government has stopped making loans through private companies and now issues them directly to students.

Sallie Mae still has $146 billion of federal college loans on its books. The cash it gets from those will keep the lights on while it seeks to make headway in the private student loan market, according to analyst Michael Taiano of Sandler O'Neill & Partners. "They have this cash cow, which is the legacy portfolio," Taiano says. "The market was not appreciating the underlying cash generation of that portfolio." The loans will throw off about $14 billion in pretax cash over the next 20 years, estimates analyst Brian Charles of R.W. Pressprich in New York.

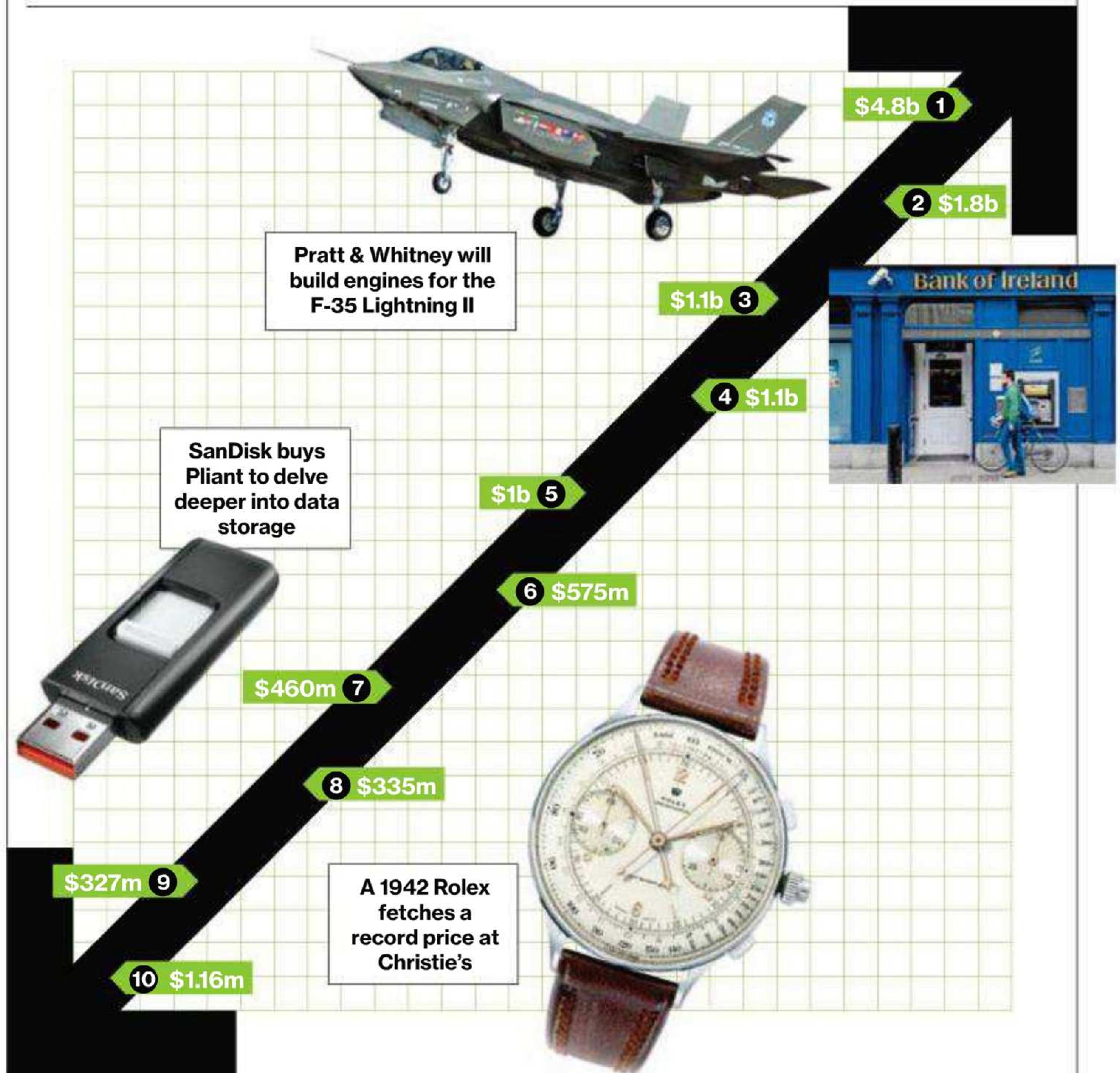
After a surge in late payments, the company tightened credit standards and stopped lending to nontraditional students such as those who attend for-profit and vocational colleges. As a result, its volume of private loans fell to $2 billion in the school year starting in 2009, from $8 billion during the 2007 year.

Now Sallie Mae is poised to increase private lending, says Charles. It has started a program that allows students to make payments while still in school, shortening the life of the loan and reducing interest costs. On May 16 the lender lowered interest rates as much as one percentage point for the upcoming academic year. Sallie Mae originated $940 million in private student loans during the first quarter of this year, up 12 percent from last year's first quarter. Tuition increases mean students have to borrow more, and they haven't stopped the pool of potential Sallie Mae customers from growing. The company says that in the first quarter of this year, applications were up 8 percent over last year's first quarter. B —*Sarah Mulholland*

The bottom line *Supported by cash from its $146 billion government loan portfolio, Sallie Mae aims to build its private student lending business.*

Bid & Ask

by Ira Boudway



1. Board members at German engine maker **Tognum** agreed to a $4.8 billion takeover bid from Daimler and Rolls-Royce Group after the suitors raised their offer from $4.4 billion.

2. **Bank of Ireland**, the nation's largest bank, is preparing to sell $1.8 billion in U.S. real estate loans after regulators ordered it to shrink its balance sheet.

3. The U.S. Defense Dept. awarded Pratt & Whitney, a **United Technologies** company, a $1.1 billion contract to produce engines for the F-35 Lightning II jet fighter.

4. **Joy Global** agreed to buy LeTourneau Technologies from Rowan Companies for $1.1 billion, adding oil and gas drill rigs to its line of mining equipment.

5. In a bid to increase Internet sales, **Allstate**, the largest publicly traded auto insurer in the U.S., is buying Esurance and Answer Financial from White Mountains Insurance Group for about $1 billion.

6. **Publicis Groupe**, the French advertising company that owns the Leo Burnett and Saatchi & Saatchi agencies, is purchasing Princeton (N.J.)-based digital marketing agency Rosetta for $575 million.

7. In its second major deal in May, Israel's **Teva Pharmaceutical Industries** agreed to pay $460 million for 57 percent of Japanese generic drugmaker Taiyo Pharmaceutical Industry.

8. Real estate investment trust **DiamondRock Hospitality** agreed to buy the 712-room Radisson Lexington Hotel in Midtown Manhattan for $335 million.

9. Flash memory drive maker **SanDisk** will pay $327 million for Pliant Technology in a bid to expand its sales of data storage devices for business.

10. A **Rolex** wristwatch made in 1942 sold for $1.16 million at a Christie's auction in Geneva on May 16. The stainless steel chronograph, one of 12, set the auction record for a Rolex.

2: AIDAN CRAWLEY/BLOOMBERG; 3: DEFENSE DEPT; 10: CHRISTIE'S IMAGES LTD. 2011

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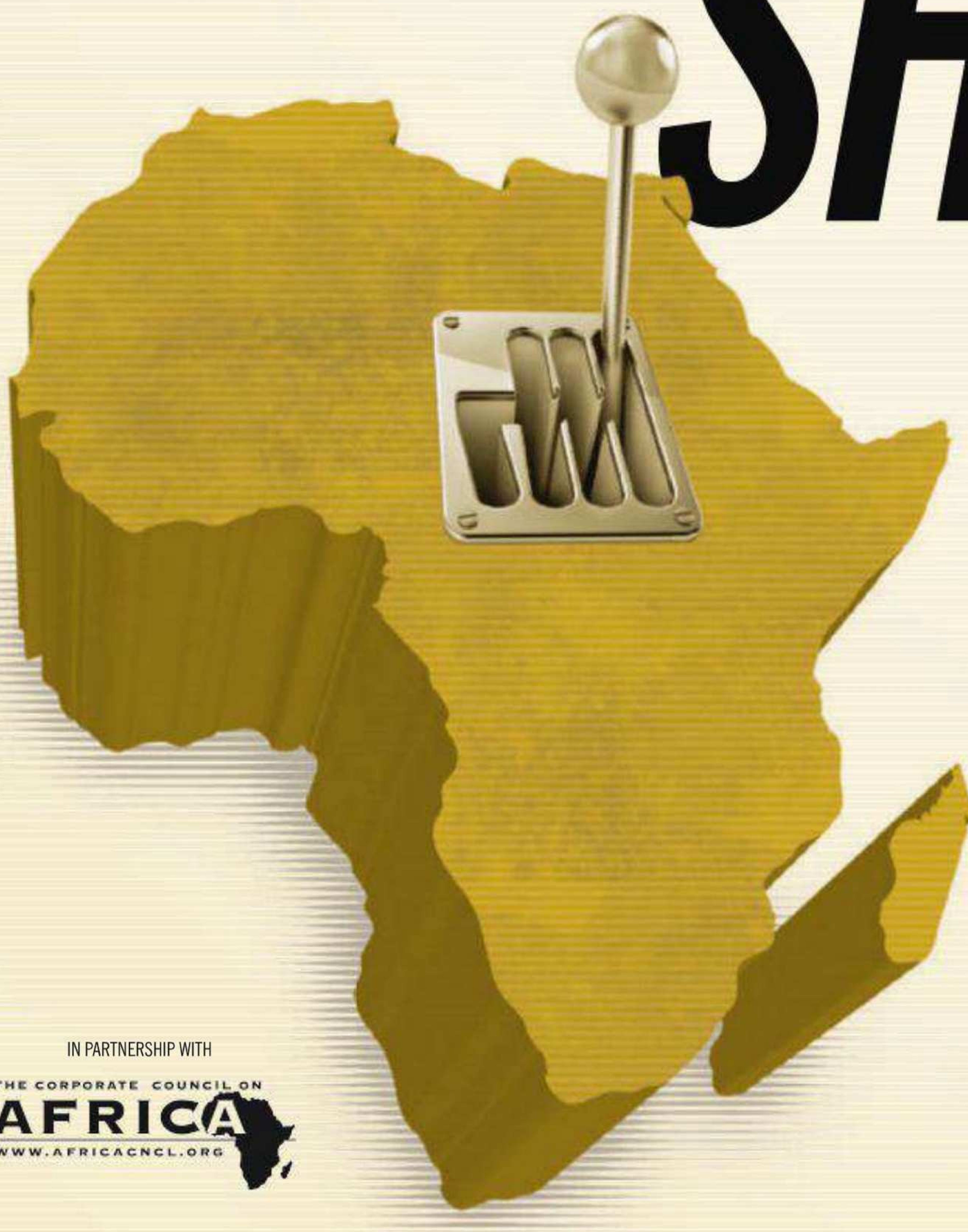
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Home to the majority of the world's fastest-growing economies, Africa is poised to fulfill its vast potential

Africa has long fired the imagination of poets and novelists, adventurers and fortune seekers. The continent holds great romance, which is why Africa has traditionally been a place about which many prefer to rely upon the picture in their mind's eye, good or bad, instead of rigorous analysis.

The recent upheaval in North Africa underscores the point. Some see Egypt, Tunisia and Libya as only the most recent examples of consistent political turmoil. Others of a more methodical bent might point to the fact that Africa has moved from almost three dozen dictators in power in the 1980s to 11 in the span of a generation. The forest of improved governance tends to be obscured by an emphasis on this or that tree.

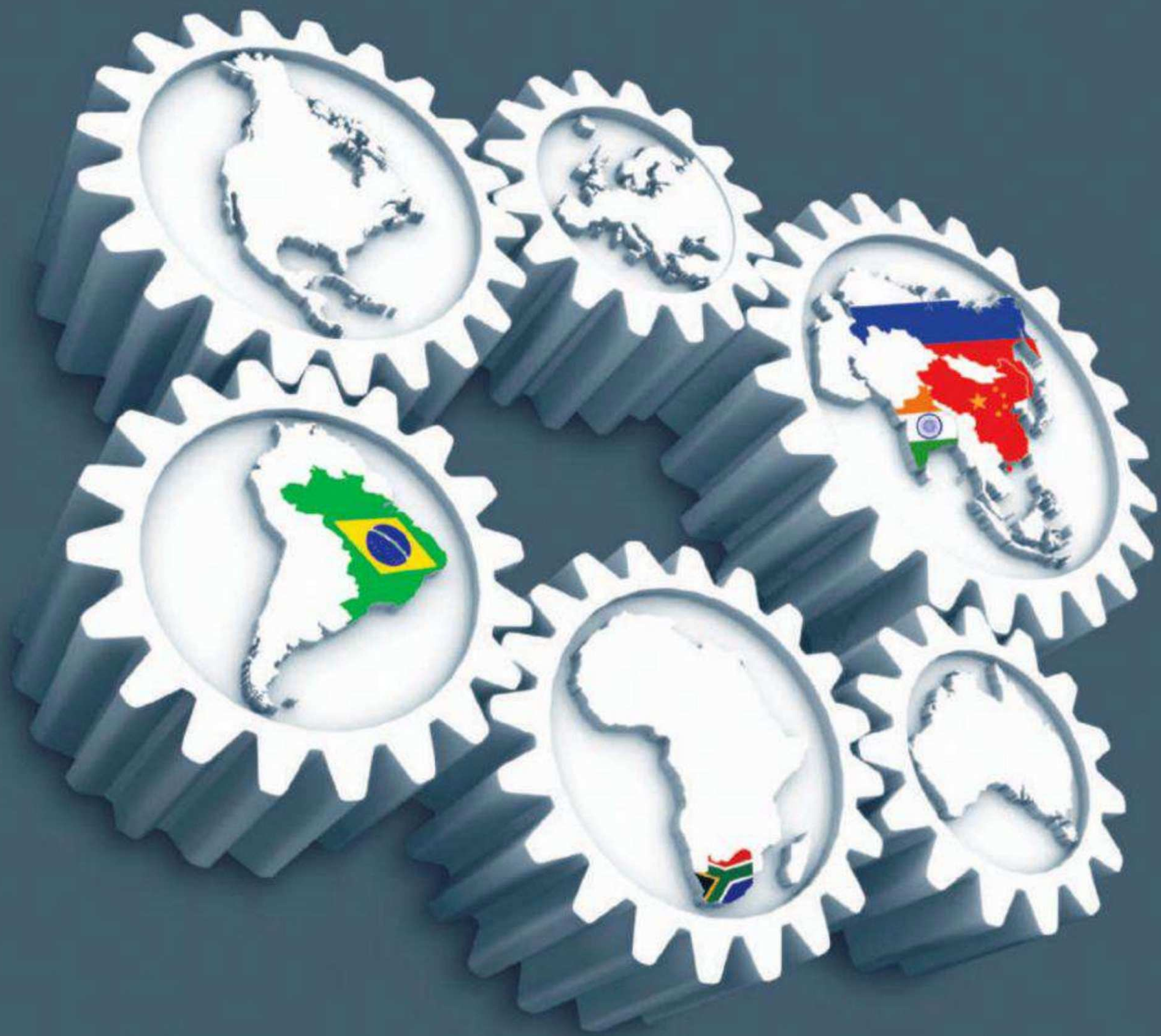
Mike Dignam is president of PAE, a global company that has supported stabilization missions in Africa for the past two decades, as well as the current chairman of the Corporate Council on Africa (CCA), a Washington, D.C.–based association focused on strengthening commercial relationships between the U.S. and Africa. He notes that while many countries still face the challenges of instability and weak civil infrastructure, progress has been made in understanding the causes of these issues and developing partnerships to act on long-term sustainable solutions. "In countries where the U.S. has partnered with the local government, such as Liberia or Djibouti, the economic and entrepreneurial energy is evident," says Dignam. "U.S. businesses have started to see the opportunity in these markets. Their investment in the local

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Left: *"Battle of the Markets," outside the stock exchange in Johannesburg. South Africa's inclusion in BRICS helps push the entire continent forward.*

economies, coupled with the strengthening civil infrastructure, gives us great hope for Africa's future."

"The media focus is on the more negative aspects of Africa—frankly, they make better news stories," says CCA president Stephen Hayes. "But there's a lot more out there. Everyone else around the world—China, Brazil, India, the Middle East—is beginning to understand the importance of Africa. In fact, we in the U.S. probably need Africa more than Africa needs us right now."

Indeed, for all the attention rightly paid to China, Standard Chartered forecasts Africa's economy to grow faster than China's over the next two decades, at an average annual rate of 7 percent. From 2000 to 2010, seven of the 10 fastest-growing economies were African countries. The African telecom industry has grown at an annual rate of 40 percent over the last five years, and the continent has the same number of cities with a population of over one million people, 52, as Europe.

"You can put the United States in Africa four and a half times, yet we read about Tunisia and fear it's going to affect Botswana," notes CCA's Hayes. "Africa is a big place, and there are a lot of good places to invest."

Larry Seruma, chief investment officer of Nile Capital Management, which manages the Nile Africa Fund, agrees. He calls "information deficit" the biggest challenge to attracting U.S. investment, and notes, "There is still a perception that Africa is a homogenous place. Africa should be seen as 53 separate, often very different countries."

If the perception of Africa has lagged behind the reality of its progress, the positive news—for starters, increased consumer buying power and demand; improved infrastructure, regional cooperation and standardization of law; diminished political risk overall—is becoming harder to ignore.

The rising power of the African consumer can be seen in many areas, perhaps none so obvious as information and consumer technology. There are 100 million Internet users in Africa today, up from just a few million a decade ago; and 70 percent of the population of Sub-Saharan Africa (SSA) lives within the coverage footprint of a mobile network (up from 20 percent). SSA mobile penetration has risen from below 1 percent to more than a third of the population in the majority of these nations.

Nick Foggin, senior advisor, telecommunications, at RP Capital Group points to the deployment of subsea fiber along the western and eastern seaboards of Africa, and the rollout of mobile broadband networks across the continent, as the key developments in the sector. "A decade ago, the ICT sector was the preserve of a rich minority," Foggin says. "Today, key technologies are fast becoming available to the masses."

With an estimated 60 percent of the world's uncultivated arable land, Africa's potential growth in agribusiness makes it the logical future cornerstone of global food security; McKinsey & Co. estimates that the world's top five countries in available acreage are Sudan, DRC, Angola, Zambia and Mozambique. Agriculture accounts for more than one-fifth of Africa's GDP, while growing at a 4–5 percent annual clip.

"Africa can bring land that wasn't available to fruition—and has the dynamics to derive more productivity from it," says Nile Capital Management's Seruma. "It's easier to start fresh than to change your whole business model, and Africa can be environmentally friendly and more productive, even at a lower cost."

The potential of Africa is part of the reason that the emerging-market BRIC nations—Brazil, Russia, India and China—recently invited South Africa to join their ranks. It is a decision of major import both economically and diplomatically.

"South Africa being asked to join BRICS [the new designation] opens up exciting new possibilities for trade and investment," says Miller Matola, CEO of the International Marketing Council of South Africa. "But it also helps our continent to grow in order to address the needs of its people. South Africa, and therefore Africa, will now have a voice in key global forums that will allow it to contribute to the reform of the U.N. and global financial, developmental and trade architecture."

There are naysayers—among them, the man who coined the term "BRIC," Goldman Sachs' Jim O'Neill—who argue that South Africa's smaller population and GDP, for starters, make it an awkward fit. Matola and others counter by pointing to the country's leadership role on the continent and the link it provides to more than one billion consumers. "It is not as if South Africa is being done a favor," Matola says. "The original four BRIC nations clearly wanted greater access to the burgeoning African economy. South Africa has an economic presence in the vast majority of the nations in Africa. It's a two-way trade."

NADINE HUTTON/BLOOMBERG

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In its 2011 Africa Attractiveness Survey, Ernst & Young asserts that, as a region, Africa should be competing in the BRICS space: "In terms of the number of FDI [foreign direct investment] projects, China is a clear leader, India a distant second, and Africa is in third place, having overtaken Russia following the economic crisis."

The case for South Africa in BRICS is bolstered by, among other recent news, Walmart's bid to acquire 51 percent of local retailer Massmast for $2.5 billion and Japan's ongoing $260 million takeover of Freeworld Coatings. Last year saw $4 billion of investment flow into South Africa, creating 13,000 jobs, and the country's Minister of Trade and Industry, Rob Davies, projects $17 billion worth of investment in the country over the next three years—expected to come not only from the BRICS powers but all the major advanced economies, as well.

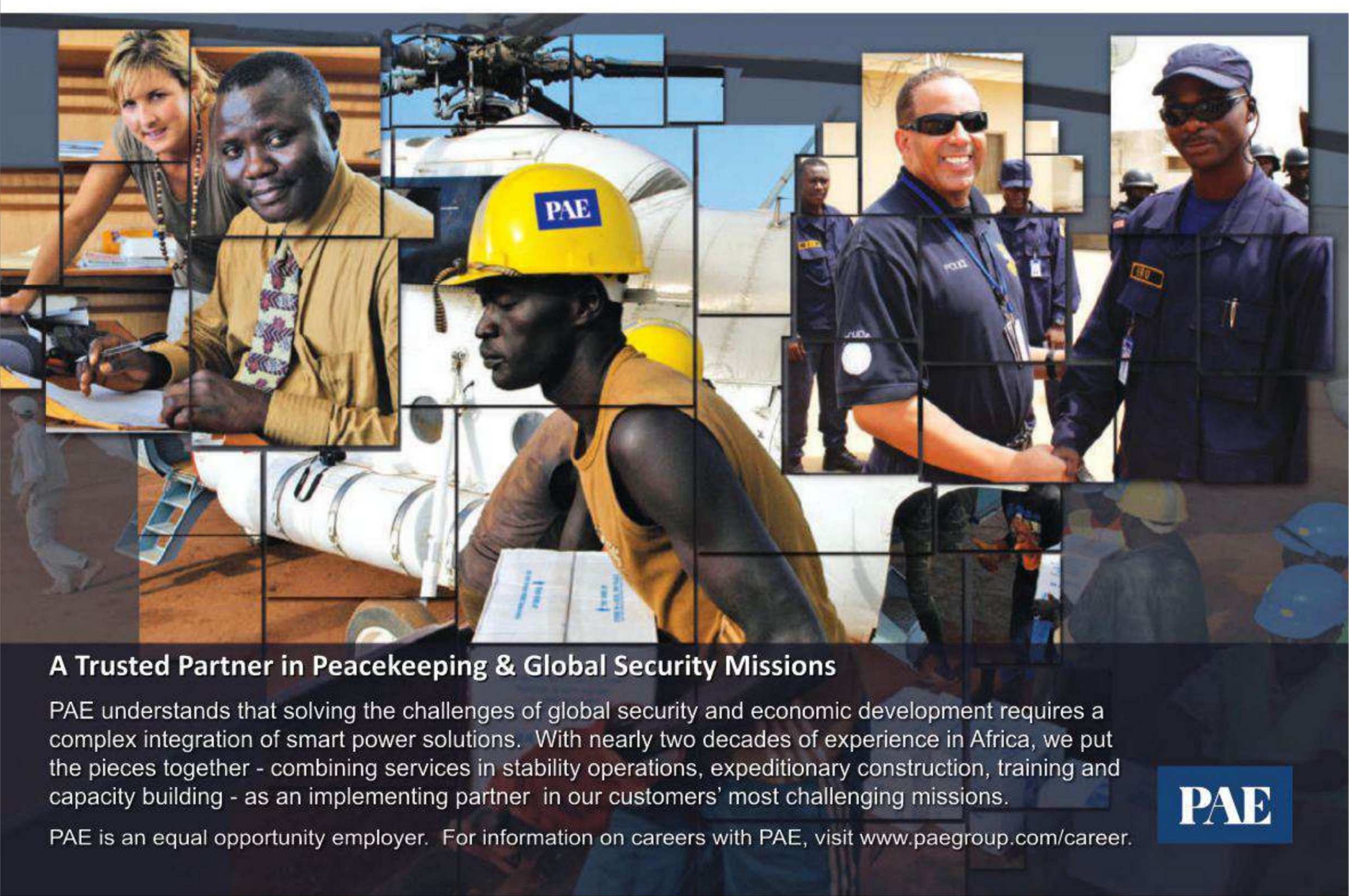
To what extent the U.S. will be a player in Africa moving forward remains an open question. Many interested observers, CCA's Hayes among them, believe the American government needs to do more to support U.S. private-sector investment in Africa, from greater on-the-ground support to making it easier to procure deal financing. The American mindset, they argue, must also change, viewing Africa not from an aid perspective, but as a business partner.

"The Secretary of Commerce hasn't visited Africa since 2002," notes Hayes, who expects approximately 1,500 attendees at CCA's U.S.–Africa Business Summit on October 5-7 in Washington, D.C. "The U.S. Department of Commerce is planning to close down three commercial services offices in Africa that are very important to us when Africa needs to be high on the horizon."

"The [African] countries have realized that economic growth is a key factor in achieving and maintaining stability," says PAE's Dignam. "In the U.S., the better we integrate the foreign assistance capacity-building initiatives, the greater success we will have in developing sustainable economies that will drive foreign direct investment opportunities."

Africa used to be associated with high risk. Increasingly, it seems that failure to prioritize Africa is itself high risk.

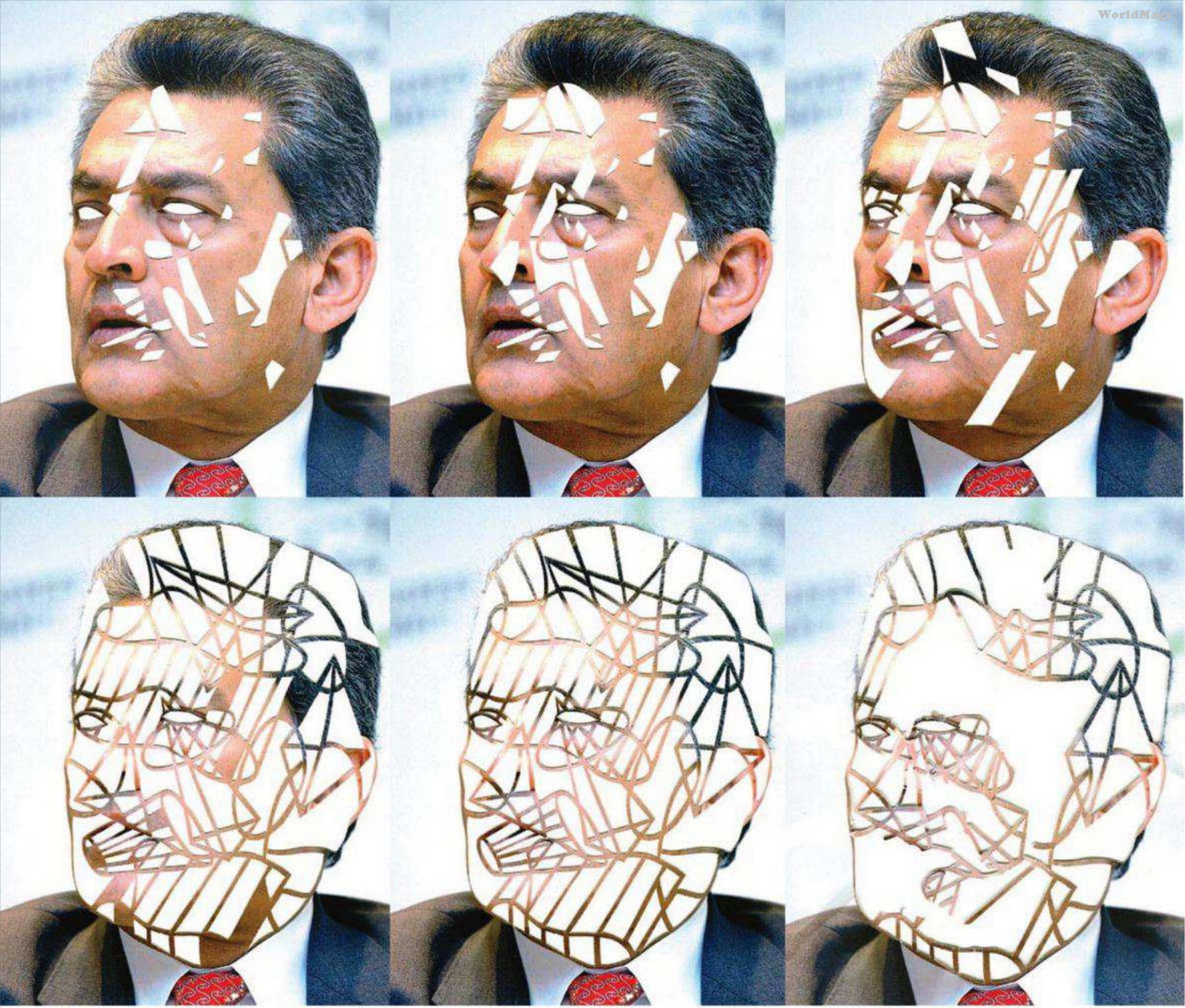
"BRICS says to all and sundry that Africa has shifted from receiving aid to being a competitor for trade and investment," says Matola. "That message should tell the U.S. and the rest of the developed world to start competing for this new African market of a billion consumers. But is the U.S. private sector fired up enough about Africa? This continent is an economic frontier with real opportunities to be grabbed." ●





Former McKinsey head Rajat Gupta was a gilded member of the corporate elite. But a tape of his voice, divulging secret details of a Goldman board meeting to a convicted hedge fund manager, cost him what no amount of money can buy

By Suzanna Andrews
Photo illustration by Gordon Magnin



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How Gupta Came Undone

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Although he would be described later by friends—in a conversation captured on an FBI wiretap—as being on the verge of "a massive implosion," Rajat K. Gupta appeared relaxed as he greeted hundreds of guests on the manicured lawns of his estate in Westport, Conn., on the afternoon of June 21, 2008. The occasion was the marriage of the eldest of his four daughters, Geetanjali, and it was a lavish affair—"the wedding of the decade," one guest called it in an account published in the *African Sun Times*. The invitations had been trimmed with gold, many of the guests flown in from around the globe. Photographs show a large Hindu temple garlanded with flowers, women in glittering saris, the bride's father, in traditional kurta pajamas, mingling with his guests in the gardens outside his French Provincial-style mansion. It was an event that was in keeping not only with Gupta's wealth but also with his corporate stature. The former head of McKinsey and a trusted *consigliere* to chief executives around the world, he was a director of American Airlines, Procter & Gamble, and Goldman Sachs, and sat on the boards of the Rockefeller and the Bill & Melinda Gates Foundations. At the time, he was also that rare businessman whose integrity was considered beyond reproach.

Yet if the Securities and Exchange Commission is to be believed, just 11 days before his daughter's wedding celebration, Gupta had done something virtually no one who knew him could have imagined. According to the SEC, it was on the evening of June 10, 2008, that Gupta, in "a flurry" of phone conversations with Raj Rajaratnam, the founder of the Galleon Group of hedge funds, allegedly divulged Goldman Sachs's still secret second-quarter earnings.

In early March, the SEC stunned global business circles when it filed a civil administrative proceeding against Gupta, accusing him of leaking information from confidential boardroom discussions held by Goldman and Procter & Gamble to Rajaratnam—accusations Gary P. Naftalis, Gupta's attorney, calls "baseless." Gupta has not been criminally charged, but for seven weeks this spring, during Rajaratnam's sensational insider trading trial, hardly a day passed when Gupta's name was not mentioned. Although federal prosecutors called him an unindicted "co-conspirator," he never appeared at the trial. But jurors heard his voice, caught on an FBI wiretap, resonating through the courtroom, saw his face in a photograph beamed onto a large video screen, and listened as his professional and personal lives were dissected by federal witnesses. While Rajaratnam is alleged by the SEC to have made more than $17 million from Gupta's information, what Gupta himself might have earned is less clear.

Gupta has been removed from the prominent corporate and philanthropic boards on which he once served and is shunned by business leaders who were once his friends. His spectacular fall from grace has left the world's leading companies shocked and mystified. Rajaratnam's conviction on 14 counts of fraud and conspiracy on May 11 closes a central chapter in the story, but Gupta's alleged role in the scandal raises new and pressing questions about the motivations of one of the world's most connected and trusted corporate insiders, about his past, and about who Rajat Gupta really is. If the SEC is correct about the secrets he shared, why would he risk so much for so little?

Impeccably tailored, articulate, charming, and worldly, Gupta, 62, had a quality that set him apart from most other business leaders. Apparently ego-less, he could sit in high-level meetings for hours listening intently but never speaking. As Joel Bleeke, Gupta's former McKinsey colleague, told the *Chicago Tribune* in 1994, his style had a "very Eastern orientation," emphasizing "wisdom rather than pure intellect." Gupta read Indian poetry and quoted Gandhi, which impressed men such as Alan G. Lafley, the former CEO of Procter & Gamble, who before Gupta's fall was quoted in the press comparing him to the 13th century saint and philosopher Thomas Aquinas. Gupta's ability to understand what Bleeke described as "the softer, emotional sides of people" made others trust him. Yet, as Gupta himself admitted, it also often left people wondering what he was really thinking.

"I could be more direct and forthright," Gupta said in a 2001 interview. "Sometimes my colleagues, of course, find that a very frustrating process, and they think, 'Why don't you say what exactly you mean?'" There were those who described him as Taoist in his approach to life—patient, calm, almost recessive. Or, as Gupta once told India's *Business Today*, "generally, I'm a soft person." But that masked a tougher side. As *The Economist* wrote in an article about McKinsey published in July 1996, "There is something of the predator in his quietness."

Born in Calcutta, Gupta is the son of Pran Kumari Gupta, a Montessori schoolteacher, and Ashwini Kumar Gupta, a journalist who had been a prominent figure in the fight for India's independence and "had been to jail many times" for his cause, as Gupta told *Business Today*. When Gupta was 5, the family moved to New Delhi, where his father helped to found a newspaper, the *Hindustan Standard*. Gupta was 16 when his father died. His mother died two years later, leaving Gupta to care for his two sisters and a brother. The siblings refused to be separated. "We decided to live by ourselves," Gupta said. "It was pretty unusual in those days. Normally we would have been sent off to live with various relatives. Instead we asked a spinster aunt to come and live with us." Their education was paid for with the help of scholarships. "We were all good students," Gupta once said, noting that when he was 18 he ranked 15th in the nationwide entrance exam for the Indian Institute of Technology, where he was awarded a scholarship.

IIT is considered among the most competitive, elite universities in the world, and its alumni include Sun Microsystems co-founder Vinod Khosla, Juniper Networks founder Pradeep

When Gupta joined McKinsey, it was relatively small. He aggressively expanded the firm, changed the pay structure—and was accused of watering down its vaunted principles

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Gupta, here in 2010, was on the board of American Airlines from 2008 to Mar. 7, 2011

Sindhu, and former Citigroup Senior Vice-Chairman Victor J. Menezes. Many of them, according to Vivek Wadhwa, a professor of engineering at Duke who has studied the Indian business community in the U.S., came to America to escape the economic chaos of Indira Gandhi's India, attending its top business and engineering schools and eventually forming the nucleus of what today is referred to as the "Indian mafia." After graduating from IIT with a degree in mechanical engineering, Gupta, again aided by scholarship money, went on to Harvard Business School. Later, he recalled that he had never seen a TV before he got to Harvard.

Gupta joined McKinsey in 1973, the year he graduated. He would eventually head the consulting firm's Scandinavia offices and then its Chicago office. In 1994 he was elected to lead McKinsey, becoming the first non-American-born managing director of the firm. Reelected to two more terms, the maximum allowed, he ran McKinsey until 2003. For nine years, Gupta led a firm that was not only considered "one of most prestigious organizations in the corporate world," in the words of Anat Lechner, a professor of management at New York University's Stern School of Business, but among the most influential. The management consultant of choice for CEOs at the world's major corporations, McKinsey was the power behind the throne, whose advice guided the restructuring of not just individual companies but entire industries.

When Gupta joined McKinsey, it was still a relatively small, genteel partnership run according to the obsessively high standards of its early leader, Marvin Bower. Consultants were drawn from the top tier of the country's best business schools; its advice was regarded as gospel, its impartiality considered untainted by the firm's pursuit of profit. By the time Gupta took over, however, McKinsey was under pressure from an increasingly competitive market, and under his leadership it underwent a massive change. He aggressively expanded the firm, nearly doubling its size, to 891 partners. He changed the pay structure, enriching partners relative to the younger members. He helped increase revenue 280 percent, to $3.4 billion, but in the process was accused of presiding over the watering down of McKinsey's vaunted principles.

In the '90s the firm began accepting payment from its clients in stock, which had once been regarded as tainting the impartiality of its advice. It was on Gupta's watch that Enron, a company closely tied to McKinsey, collapsed.

Some blamed Gupta for the tensions that arose during his tenure and for the fraying of the firm's standards. Others say the blame is misplaced. Former McKinsey Managing Director Ron Daniel once compared the CEO's job to trying to herd cats; Gupta himself described it as "a sort of servant-leader job," with "at least 150, if not 400, leaders." The challenge, Gupta said, was to "figure out what their aspirations are, synthesize them, and distill them in the direction the firm should take." However controversial his direction was, says one former partner, the fact that Gupta was elected three times by the partners shows he had significant support.

The firm's culture may have shaped Gupta more than he shaped it. McKinsey had a culture of superiority, says one longtime client, who declined to be identified, adding that consultants at the firm really seemed to think they were better than anyone else in the business world. This CEO is still shocked recalling an incident in the late 1980s, when a McKinsey team offered to provide him with a road map of what his competitors were doing. When asked how they could produce such information, he was told that McKinsey also worked with his competitors, but he could trust McKinsey to know what was confidential information and what was to be kept private. He says arrogance permeated the firm.

PREVIOUS SPREAD: GUPTA: SEOKYONG LEE/BLOOMBERG; THIS PAGE: RAMIN TALAIE/BLOOMBERG

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The usual rules seemed not to apply. When this CEO listened to a wiretapped phone call from July 2008, in which Gupta relayed to Rajaratnam the details of the Goldman board's discussions about buying a commercial bank, it sounded to him just like Gupta consulting a client.

During the years he ran McKinsey, money never seemed to be much of a concern for Gupta. He lived well on his salary, which is estimated by friends and former McKinsey employees at anywhere from $5 million to $10 million. In 1999, according to real estate records, he paid $6 million for his Westport mansion, once owned by the J.C. Penney family. He had a vacation home in Florida, and in 2000 he bought a luxury condominium on Central Park West. He put his four daughters through private school, and then Ivy League colleges. In the Indian-American community, especially among his fellow IIT graduates, there were many men who were far richer, but Gupta had prestige. In this "tightly bonded," achievement-oriented, highly competitive community, Gupta was "an icon," says Duke's Wadhwa. "He was a legend—very, very highly regarded."

There are questions today, however, as to how content Gupta really was during those years. According to a report by Bloomberg News, Gupta ran a consulting business called Mindspirit on the side, unbeknownst to McKinsey and in violation of its rules. But the story was even more complicated.

Mindspirit was formed in 2001, according to Anil Kumar, the McKinsey partner accused of taking nearly $2 million from Rajaratnam in return for insider tips on McKinsey clients. As Kumar testified at Rajaratnam's trial, Mindspirit was a company created to handle investments for both his and Gupta's families. That same year, according to SEC documents, Mindspirit entered into a "consulting" agreement with Infogroup "to provide advice and guidance to Vin Gupta," its then-CEO who was also a friend of Rajat Gupta, a fellow IIT graduate and another founding member of the American India Foundation. As payment, Mindspirit received 200,000 stock options, all of which were exercised. In an August 2008 SEC filing, however, Infogroup would say that this payment was not approved by the company's board. The filing—which disclosed the settlement of a shareholder suit against Vinod Gupta for using company funds for personal expenses, including cars, a yacht, jets, and consulting fees paid to his wife—also suggested that the board had no idea Mindspirit was doing any work for the company. When asked about it, Vinod Gupta said, according to the filing, that it "was created by the wives of Rajat Gupta and Anil Kumar, two employees of McKinsey & Company who were rendering business advice."

In 2003, Rajat Gupta stepped down as McKinsey's chief. He would remain at the firm as a senior partner until 2007, but the diminished role marked a huge change in his life. Almost overnight he lost what NYU's Lechner calls "the halo effect" of his position and the tremendous status it conferred. It was around this period, according to some of his friends, that Gupta began to express a certain resentment about money. The wealth of some of his peers in Silicon Valley was mind-boggling; many of them had mega-mansions that made his own lavish residence appear modest. The same was the case with his counterparts on Wall Street. The equity markets were booming, and McKinsey's private equity clients were the new Wall Street royalty, raking in staggering amounts of money while Gupta soldiered on with a mere senior partner's millions—or at least appeared to be doing so. Whether he received any other payments through Mindspirit is unclear. According to Bloomberg News, Gupta also consulted on the side for an outsourcing company called Genpact, whose board he joined in 2007, the year he left McKinsey.

Gupta was still at McKinsey when, in 2006, he tried to set up his own private equity and hedge fund—his first deal involving Rajaratnam. This first attempt stalled, but several months later, Gupta, along with Parag Saxena, a former Citigroup executive and managing partner of Invesco Private Capital, succeeded in co-founding New Silk Route, a private equity fund that would invest in ventures in India and other emerging markets. The fund eventually raised $1.3 billion, $50 million of which came from Rajaratnam.

In 2007, Gupta joined with Rajaratnam in another venture, helping to found the GB Voyager Multi-Strategy Fund, a $40 million master fund that would invest in numerous Galleon hedge funds, including those that later, according to the SEC's complaint, "traded on Gupta's illegal tips." Gupta invested $10 million in the fund, all of which, according to his attorney,

Anatomy of a Trade

SEPTEMBER 2008 In the throes of the financial crisis, Goldman Sachs announces that Berkshire Hathaway is investing $5 billion in the company. Before this, according to the SEC, there was a series of trades:



SUNDAY, SEPT. 21, 2008
Goldman Sachs executives including Gupta discuss possible "strategic alternatives," including a potential investment from an institutional investor such as Berkshire.

MONDAY, SEPT. 22 A.M.
Gupta and Rajaratnam "very likely" have a telephone conversation. Shortly after, Rajaratnam causes the Galleon Tech funds to purchase more than 80,000 Goldman shares.

TUESDAY, SEPT. 23 A.M.
Rajaratnam calls Gupta. Less than a minute after the call begins, Rajaratnam causes the Galleon Tech funds to purchase more than 40,000 additional Goldman shares.

3:15-3:53 P.M.
Goldman's board approves but doesn't publicly disclose a $5 billion preferred stock investment by Berkshire in Goldman and a public equity offering. Gupta participates via phone, staying connected until "approximately" **3:53 p.m.**

SOURCE: THE SECURITIES AND EXCHANGE COMMISSION

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Gupta's Connecticut property includes a Hindu temple

Gary Naftalis, he lost. However, Galleon records submitted by federal prosecutors during Rajaratnam's trial by June 2008—the month the SEC alleges that Gupta tipped Rajaratnam off to Goldman's second-quarter earnings—show that Gupta's investment in the Voyager Fund was listed in Galleon's books at $16.4 million. By then, according to trial testimony and wiretaps presented by federal prosecutors, Gupta was negotiating with Rajaratnam for a 10 percent to 15 percent stake in the Galleon International Fund in exchange for attracting investors and becoming the fund's chairman.

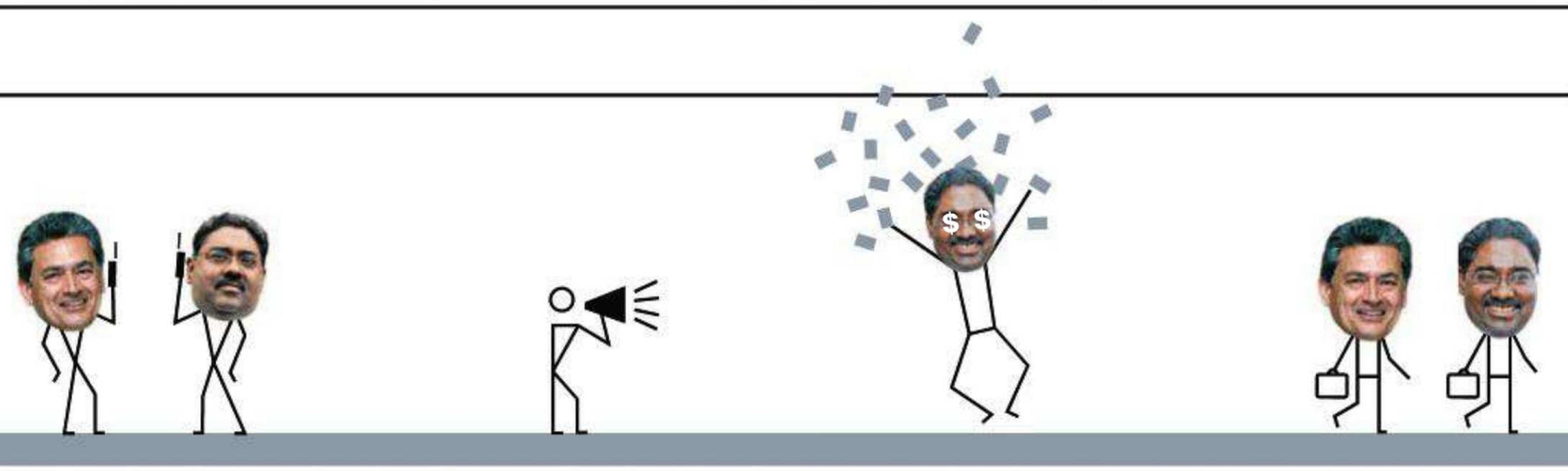
Exactly when Gupta first met Rajaratnam is unclear. Around 1999, Rajaratnam made a large donation to the Indian School of Business, in Hyderabad, which Gupta had helped found. Rajaratnam followed up on his donation to the ISB with one to the American India Foundation, a philanthropic group made up largely of wealthy, high-powered Indians and Americans organized in the aftermath of the 2001 Gujarat earthquake and of which Gupta was a founding member. In return for his money, the Sri Lankan-born Rajaratnam became an AIF trustee—whose board includes former President Bill Clinton as honorary chair—and by the mid-2000s he and Gupta had become close friends.

Rajaratnam was well-connected and seductive. But by 2006, it was well-known that he had been under regulatory scrutiny. The year before, Galleon Group had paid a $2 million fine and disgorged profits to settle charges that it had made improper trades. Some of Gupta's friends were also concerned about Gupta's ties to Saxena and Victor Menezes, the former Citigroup vice-chairman who had become a senior adviser at New Silk Route, who had also had troubles with the SEC, resulting in fines. In 1994, Saxena settled charges that he had received pre-initial public offering stock at big discounts and then recommended it to his clients at Chancellor Capital Management after the companies went public. In 2006, Menezes paid the SEC $2.7 million in a fine and also disgorged profits after he sold Citigroup stock ahead of an announcement of bad news from an Argentinian subsidiary. Both men neither admitted nor denied wrongdoing. "I told him once, if you are in a herd of pigs, you'll also smell like a pig," Bala Balachandran, a business professor who has known Gupta for decades, said last year. Gupta shrugged off the warnings.

It was as though he were leading two lives. And one was apparently riskier than he realized. It was in early March 2007, shortly after Gupta had begun doing business with Rajaratnam, that an anonymous letter was sent to the SEC about insider trading at Rajaratnam's Galleon, alleging, among other things, that its limited partners held positions such as chairman, chief financial officer, and director of large public companies and that they faxed privileged information to Galleon. "In return, the fund provides greater returns on their money," it said, according to media reports of the letter, which was read by federal prosecutors at a pretrial hearing on the Galleon case. It was not until early 2008, however, about a year after the letter was received, that federal prosecutors won court authority to wiretap Rajaratnam's phone.

According to the transcript of the wiretapped conversation, it was Gupta who, at 5:39 p.m. on July 29, 2008, put in a call to Rajaratnam from his office at McKinsey's Stamford (Conn.) headquarters. He appears to be returning one from the hedge fund manager, who quickly gets to the point: He's got an upcoming meeting with Goldman Sachs President Gary D. Cohn, and he wants to know if there's any truth to the rumor he's heard that Goldman's board has considered buying a commercial bank. On the audio of the wiretap, Gupta responds without hesitation.

"Yeah, this was a big discussion at the board meeting." He goes on to tell Rajaratnam that the discussion was



3:56 P.M.
Gupta calls Rajaratnam. At 3:56 and 3:57 p.m., moments before the close of the markets, Rajaratnam causes the Galleon Tech funds to buy more than **175,000 additional Goldman shares.**

After Market Close
Goldman Sachs's stock price closes at $125.05 per share. The Berkshire investment is announced after the market closes, along with a $2.5 billion public stock offering.

WEDNESDAY, SEPT. 24
Goldman's stock opens at $128.44. Rajaratnam causes the Galleon Tech funds to liquidate the long position they had built on Sept. 23, generating profits of more than $900,000.

SEPT. 24: After Market Close
Goldman's stock price rises to a closing price of $133.00 per share, a gain of 6.36 percent from the prior day's close.

ANATOMY OF A TRADE: XINHUA /LANDOV; SATISH KAUSHIK/THE INDIA TODAY GROUP/GETTY IMAGES; PETER FOLEY/BLOOMBERG; RICK MAIMAN/BLOOMBERG; JOHN THYS/AFP/GETTY IMAGES

"uh, divided," and mentions Wachovia as a possible acquisition candidate.

"Or even AIG, right?" Rajaratnam asks.

"AIG, it was definitely on, in, in, in, the discussion," says Gupta.

What follows is a bitch-fest about Anil Kumar, Gupta's partner in Mindspirit. Kumar would eventually turn state's witness after confessing to taking millions in payments from Rajaratnam in return for insider tips on such McKinsey clients as the chipmaker Advanced Micro Devices. According to Rajaratnam, Kumar at the time of the phone conversation was asking for even more money. Sounding like a couple of backstabbing high school mean girls, Rajaratnam and Gupta agree he is ungrateful and pushy. "Now from, for the last three or four, I mean four or five years, I've given him a million bucks a year, right?" says Rajaratnam. "Yeah, yeah," says Gupta, who doesn't appear taken aback at all by Rajaratnam's next remark: "After taxes. Offshore. Cash." "Yeah, yeah," says Gupta.

Gupta continues, complaining about the amount of work he's being asked to do for New Silk Route, about how little his partners are doing. Several weeks before, Gupta had joined the board of Russia's Sberbank. At $525,000, his 2008 compensation was nearly five times more than the next-highest-paid director, a fact that would attract the attention of at least one shareholder watchdog group. Nevertheless, Gupta sounds eager to the point of desperation for more revenue-generating opportunities. Rajaratnam encourages him to create "a portfolio of things you enjoy doing" and suggests that working for Galleon International would be one of those things. He tells Gupta that he plans to increase the fund to $10 billion by the end of 2009. Listening to the pleading tone in Gupta's voice as he pitches himself to Rajaratnam is almost painful. "I can be helpful in Galleon International, by the way—not Galleon International, Galleon Group," he says, apparently angling for a bigger job. "I mean you've given [me] a position in Galleon International, that's good enough. I, I ... ," he breaks off.

It was during this conversation that Gupta mentioned he had an offer from Kohlberg Kravis Roberts. He wanted to know if Rajaratnam thought he should take it. The details weren't discussed, but Rajaratnam's advice was: "The KKR I would do in a heartbeat." By Aug. 15, 2008, according to a wiretapped conversation between Rajaratnam and Kumar, Gupta had apparently decided to take the KKR job and to resign from Goldman's board, a move that appears to have upset both his partners. "Is it really that he was so greedy for the $12 million that KKR has offered him?" Kumar says, telling Rajaratnam, "I asked him, 'Was [the Goldman board work] time-consuming?' And he said, 'Look, I don't make that much money from it.'"

According to Rajaratnam, part of Gupta's concern was "the perceived conflict of interest." On at least one occasion, New Silk Route and Goldman had bid on the same companies. "My analysis of the situation," Rajaratnam tells Kumar, "is he's enamored with Kravis, and I think he wants to, you know, be in that circle. That's a billionaire's circle, right? Goldman is like the hundreds-of-million-aire's circle. Right?" he says. "And I think he sees an opportunity to make $100 million over the next five years or 10 years without doing a lot of work."

"My analysis ... is he's enamored with Kravis, and ... wants to, you know, be in that circle. That's a billionaire's circle, right? Goldman is like the hundreds-of-million-aire's circle"

Whether or not that was the case, both men describe Gupta as deeply troubled and under tremendous pressure. They refer to a "personal family crisis" that Gupta spoke of several months before; about his wife Anita's unhappiness at not being able to spend more time with him, and the "innuendoes," in Rajaratnam's words, about a personal friendship with a woman in California. "What I worry is that there can be this MASSIVE implosion in him," says Kumar, who describes a recent visit to Gupta, during which Gupta "just sat there for two hours" watching television, barely speaking. "He didn't seem comfortable," Rajaratnam responds. "He seemed like he was tormented, right?"

On Sept. 9, 2008, Gupta submitted a letter of resignation to Goldman Sachs's board, saying he was taking a position as senior adviser to KKR. He was, however, convinced to stay by Goldman's CEO, Lloyd C. Blankfein, and other executives, who feared a public-relations backlash if Gupta resigned in the midst of the financial crisis. Fourteen days later, according to the SEC, Gupta had one of several phone conversations with Rajaratnam, during which he allegedly tipped him off to the Goldman's board's deliberations about a $5 billion investment in the bank by Berkshire Hathaway. A month later, according to the SEC, he would jump off a Goldman board teleconference and 23 seconds later phone Rajaratnam to inform him of the as-yet-secret information that Goldman would report a loss of $2 a share in the fourth quarter, its first and only quarterly loss since going public. On Jan. 29, 2009, after a meeting of P&G's audit committee, the SEC alleges that Gupta again called Rajaratnam to relay P&G's as-yet-unannounced fourth-quarter earnings.

That same day, Harman International Industries, the audio products manufacturer, announced that Gupta had joined its board. "Rajat's deep expertise in global business, combined with his active participation in several other prestigious governance bodies, will serve as valuable assets," Harman Chairman and CEO Dinesh C. Paliwal said in a statement. With significant investments from KKR and Goldman Sachs Capital Partners, Harman noted in a filing with the SEC that Rajat Gupta was not only a director of Goldman Sachs but also "a paid advisor to KKR." Whatever qualms Gupta had about working with both companies appear to have evaporated.

The year 2009 was a busy one for Gupta, particularly in India. That January, M. Rammohan Rao, the dean of the Indian School of Business, whose board Gupta chaired, resigned following the disclosure of massive accounting fraud at Satyam Computer Services, on whose board he served. In October the Reserve Bank of India ruled that Gupta and several other investors had acted inappropriately in buying a nearly 33 percent stake in the Tamilnad Mercantile Bank. Four months later the offices of K.S. Oils, an edible oils company in which Gupta's New Silk Route was an investor, were raided by Indian tax authorities. (The company denied any wrongdoing, but in January 2011, according to the Indo-Asian New Service, Chairman of the Board Ramesh Garg,

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Gupta's Rolodex

President Clinton Honorary Chair of the American India Foundation, Gupta's pet charity

Alan Lafley The former CEO of Procter & Gamble once compared Gupta to Thomas Aquinas

Vikram Pandit On the board of the Gupta-founded Indian School of Business

Bill Gates Gupta served on the Bill & Melinda Gates Foundation board

Lloyd Blankfein The Goldman board was Gupta's most prestigious

Michael Dell Sits on the board of the Indian School of Business

Frank Wisner On the council of trustees for the American India Foundation

Vin Gupta Gave money to Gupta's side "consulting" business, Mindspirit



FROM LEFT: JIM WATSON/AFP/GETTY IMAGES; FRANCIS SPECKER/BLOOMBERG; JIN LEE/BLOOMBERG; DANIEL ACKER/BLOOMBERG; ANDREW HARRER/BLOOMBERG; TONY AVELAR/BLOOMBERG; HANS PUNZ/AP PHOTO; CHRIS O'MEARA/ AP PHOTO

who is also a politician in the Indian state of Madhya Pradesh, was fined for tax evasion.)

On Oct. 16, 2009, Rajaratnam was arrested at his Sutton Place home in Manhattan. The news of the government's case against him would make headlines for months to come. But friends say Gupta gave no indication that he was worried. In March 2010, Goldman announced that Gupta was resigning his board position "because of other commitments." Although Blankfein would testify this spring that he had "some inkling" that Gupta was under federal scrutiny, and that he knew "there were some questions about Rajat's behavior," he issued a glowing public statement about Gupta's "important contributions to Goldman Sachs." Even *The Wall Street Journal*'s revelation, in April 2010, that Gupta was under federal investigation didn't keep him from new high-profile appointments. He would remain on the boards of American Airlines, P&G, Harman, Sberbank, and the World Economic Forum, among others, for several more months. On July 1, 2010, Gupta was elected chairman of the International Chamber of Commerce.

In late February, Gupta attended a cricket match in Bangalore. According to Shoba Narayan, the award-winning author of *Monsoon Diary*, who attended the event and wrote about her encounter with Gupta in India's *Mint* newspaper, he was sitting in the VIP section of the stadium, looking "as dapper and distinguished as ever." The SEC's order was only days from being issued, but if he was worried about what would happen, "he didn't show it." Even after the SEC charged him, there was an element of indignation and defiance in Gupta's response.

"The SEC's allegations are totally baseless," he wrote to Ajit Rangnekar, dean of the Indian Business School, in a Mar. 2 e-mail that was forwarded to faculty and alumni. "I am informed by my lawyers that the case is based on speculation and unreliable third-hand hearsay. Just to be clear: There are no tapes or any other direct evidence of me tipping Mr. Rajaratnam. I did not trade any of the securities involved, nor did I share in any of Mr. Rajaratnam's profits. In fact during the period in question, the business relationship between Mr. Rajaratnam and I were strained."

There are a number of obvious inaccuracies in Gupta's e-mail: The government did indeed have a tape; Gupta's investments in Galleon's funds suggest that he did profit from Rajaratnam's trading, illegal or otherwise; and, although he says his relationship with Rajaratnam was "strained" during 2008, the easy, friendly tone of their wiretapped conversation belies that, as does testimony from a Galleon trader that Gupta was seen in Rajaratnam's office "biweekly" during the month of September 2008.

The possibility that Gupta would lie about facts so easy to check, combined with his behavior over the previous few months, raises a welter of more complicated questions. How could Gupta have gotten involved in such a scandal? Was he ever what he seemed to be? Did he always bend the rules? Or, if the SEC allegations are true, did he fall prey to temptation only after losing his McKinsey halo?

Insider trading is notoriously difficult to prosecute successfully—one explanation, perhaps, for why Gupta has not been criminally charged. The problem for prosecutors, says Kip Weissman, a former SEC enforcement attorney and a partner at the Washington firm Luse Gorman Pomerenk & Schick, is instructive: Insider-trading convictions are hard to win because "it's a state-of-mind crime."

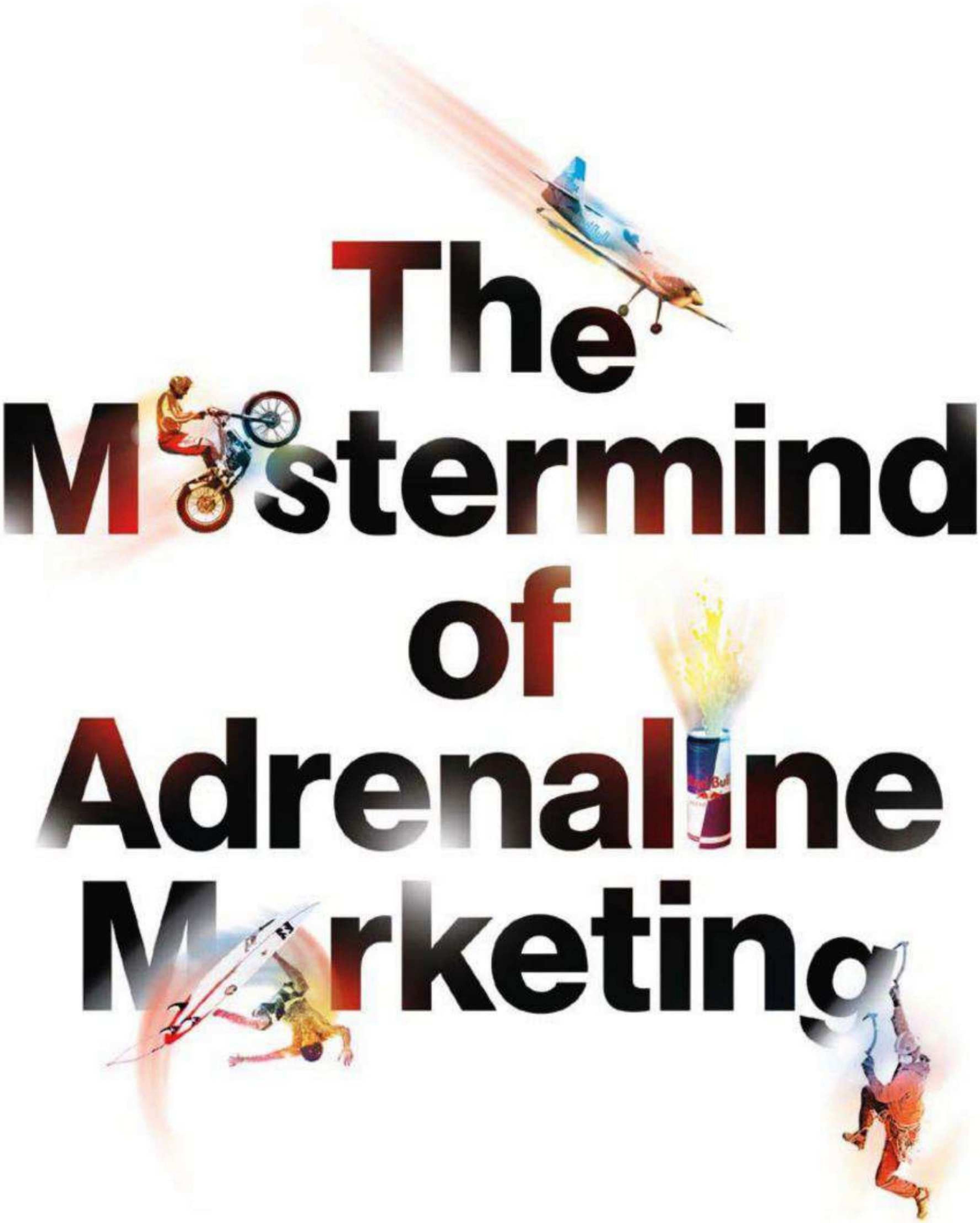
Much of the proof of insider trading hinges on intent, something that is essentially deeply psychological, and few cases have illustrated this more vividly than the allegations against Rajat Gupta. According to the SEC, Gupta's tips to Rajaratnam resulted in a gain—profits made and losses avoided—of more than $17 million. Small change for Rajaratnam, and even less for Gupta, if the allegations are true. Why Gupta risked so much for so little may never be known. It might have been "some Rosebud thing," as Weissman puts it, a chip on the shoulder, "the little demon everyone has of feeling not good enough, the reason why, with all that success, you need that little edge."

Today, legal experts believe the SEC's case against Gupta is based on heavily circumstantial evidence—including phone records, trading logs, and corroborating wiretaps. Remarkably, none of Gupta's alleged criminal tips to Rajaratnam appear to have been captured on the FBI's wiretaps.

The seeming absence of a "smoking gun," says Weissman, could be the reason why the SEC opted to bring its case against Gupta before an administrative law judge, not in federal court, where the threshold of evidence is higher and where a defendant has discovery rights. No one is certain. "A lot of us are blanking on this," says Weissman. "Why did the SEC go this route? It's very striking." Even more so because the other 27-plus Galleon-related cases brought by the SEC were all brought in federal court. In March, Gupta sued the SEC, claiming that his constitutional rights were being trampled and demanding a jury trial. That suit is currently working its way through federal court. If Gupta wins and does go to trial, it is possible he might be acquitted, given the apparent paucity of hard evidence against him. Right now, he is still scheduled to appear before the SEC's administrative judge on July 18. If the SEC wins its case, Gupta could be fined, forced to disgorge profits, and barred from the securities business. But whatever happens on the legal front, he has already lost something more valuable than any amount of money could buy. B

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The Mastermind of Adrenaline Marketing



The visionary behind Red Bull has built a $5 billion-a-year soft-drink empire. Now, Dietrich Mateschitz is making a bold move into TV, movies, and magazines. What's a beverage magnate doing in the media business? Just what he's always done: Having a blast

By Duff McDonald
Illustration by Chuck Anderson

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Little known outside of his native Austria, Dietrich Mateschitz is one of the most successful entrepreneurs of our age, a man who single-handedly changed the landscape of the beverage industry by creating not just a new brand but a whole new category: the energy drink. As the visionary who brought the world Red Bull, affectionately known as "speed in a can" or even "liquid cocaine," Mateschitz, 67, has been a patron saint for more than two decades to late-night partiers, exam-week undergrads, long-haul truckers, and, above all, extreme-sports athletes everywhere.

In return for his sickly sweet innovation, the world has made him very, very rich. Last year the privately held company, also named Red Bull, says it sold 4.2 billion cans of its drink, including more than a billion in the U.S. alone. That represents a 7.9 percent increase over the year before, and revenues jumped 15.8 percent to \$5.175 billion. Mateschitz runs an efficient enterprise that has yet to trip on its rapid growth: At the end of 2004, he had just 2,605 employees; in 2010, Red Bull employed 7,758 people—which works out to more than \$667,000 in revenue per person.

Now he's set his sights on media. On May 15, subscribers to the *Los Angeles Times*, *Chicago Tribune*, *Miami Herald*, *Houston Chronicle*, and *New York Daily News* found a magazine called *Red Bulletin* inserted in their Sunday papers. The 98-page glossy features a cover story on San Francisco Giants ace Tim Lincecum, as well as pieces on Bob Dylan, graffiti art, and Russian BASE jumper Valery Rozov. Billed as "an almost independent monthly," the magazine is a product of Red Bull Media House, a subsidiary media company launched in Austria in 2007 that expanded with a Los Angeles outpost this January.

Red Bull knows what it's getting into. Over the years, it has produced TV programs (*No Limits* on ESPN), films (*That's It, That's All*), magazines, a website, and a steady diet of Web videos featuring snowboarders, rally cars, surfers, cliff divers, and concerts. Even so, its current ambitions reflect a serious ramping up, as well as the realization of a business plan that eschews conventional advertising in favor of marketing through its own events, shows, and publications. The company shipped more than 1.2 million copies of the first *Red Bulletin* in the U.S. (equal to *Sports Illustrated*'s paid circulation). This fall its first feature-length documentary, a look at snowboarding called *The Art of Flight*, will be released in U.S. theaters. Earlier this year, the company announced a partnership with Bunim/Murray Productions, best known for creating the *Real World* reality-show franchise on MTV. The two are working on reality TV concepts for Red Bull athletes.

Mateschitz calls the multimedia assault "our most important line extension so far. As a major content provider, it is our goal to communicate and distribute the 'World of Red Bull' in all major media segments, from TV to print to new media to our music record label." He hopes Red Bull Media House will turn a profit, but, as with his sports teams, he's willing to wait. "In literal financial terms, our sports teams are not yet profitable, but in value terms, they are," he says. "The total editorial media value plus the media assets created around the teams are superior to pure advertising expenditures."

Red Bull has employees in 161 countries, but most of the major decisions still get made either at Red Bull's headquarters in Fuschl, an Austrian village of 1,500, or at Hangar-7, Mateschitz's private airplane complex a few minutes outside Salzburg.

Though he rarely gives interviews, Mateschitz's Hangar-7 provides ample evidence that he is not shy about his success. Each of his buildings features architectural flourishes that seem better suited to a design mecca like Berlin than to a bucolic Austrian suburb. "The architect almost killed me when I told him I wanted to add that," says Mateschitz, standing on a balcony and pointing straight up at the Threesixty Bar—a circular all-glass room that appears to be suspended in mid-air. It's extravagant, unnecessary perhaps, and that's precisely the point. "It wouldn't be Red Bull if it didn't start harmless and end up as a catastrophe," Mateschitz says. "And architects are really only paid discussion partners anyway."

Beyond the Flying Bulls—a performing fleet of vintage aircraft—the most fascinating parts of Hangar-7 are the restaurants, including the Threesixty Bar, the Mayday Bar, and Restaurant Ikarus. Directly below us sit a half dozen aircraft, all tattooed with Red Bull's logo, including a Chance Vought F4U-4 Corsair fighter from 1945, a Pitts S2B aerobatic biplane, two Alpha jets once used by European militaries for training, and a couple of helicopters.

Mateschitz owns four soccer teams: New York's Red Bulls (and their stadium), Red Bull Salzburg, Red Bull Brasil, and RB Leipzig. He also has a Nascar team and two Formula 1 racing teams. One Formula 1 team has on occasion been sufficient to cripple a billionaire's finances, but like everything at Red Bull, he finances the annual \$200 million cost of his F1 teams out of the company's healthy operating income.

Mateschitz is Austria's richest man, and Red Bull is the biggest thing to come out of the place since, well, Arnold Schwarzenegger. California's former governor has an idea why Mateschitz is so successful: "He's a daring businessman, but he's also quite visionary for an Austrian, because he thinks in terms of the whole world. It's one thing to think that way in America, but it's much more rare when you come from a small country like Austria."

Mateschitz's private office is called Lucky 7-Private Heaven. It's so private that we're forced to wait as he struggles

F1 driver Sebastian Vettel, a Red Bull "ambassador," gives Mateschitz a victory hug



PREVIOUS SPREAD: MATESCHITZ: GERARD RANCINAN; BLOOMBERG; IMAGEDJ/ALAMY; RED BULL CONTENT POOL (4); THIS SPREAD: BLOOMBERG (2); PETER J. FOX/GETTY IMAGES; RED BULL CONTENT POOL (3)

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Red Bull's Hangar-7, outside Salzburg, houses a restaurant, two bars, and the Flying Bulls squadron of vintage aircraft

to get the digital fingerprint reader to grant him access. It's the one time all day that he shows even an inkling of uncertainty. "I'm not really this James Bond," he says as he places his finger on the reader for the third time. "It was for my son when he was younger. But he was a little surprised when I told him that it only worked with my fingerprint and not his as well."

Once inside, Mateschitz takes his place behind a modern wooden desk that holds not a computer but rather a model plane, a bronze sculpture of two bulls flying on an eagle's wings, and a few coffee-table books—on the Belgian artist Panamarenko and the German aeronautical engineer Claude Dornier—and launches into a spiel he's been delivering for the past 25 years. In near-perfect English, he explains that Red Bull is not just a drink. Instead, it is a "philosophy"—one seemingly derived from his own outlook on life—and a "functional product," used to improve strength and performance and to revitalize the body and mind. An amiable man, Mateschitz is also quite serious, prone to beginning sentences with the phrase "It is a must." As in: "It is a must to believe in one's product. If this were just a marketing gimmick, it would never work."

He says it with such certainty that it's easy to forget that Red Bull is just a carbonated drink in an artfully designed eight-ounce can, the main ingredients of which are caffeine, an amino acid called taurine, and a carbohydrate called glucuronolactone.

Mateschitz was born on May 20, 1944— under the sign of Taurus, naturally—in the village of St. Marein, in Austria's southern region of Styria. His family was predominantly conservative, full of officers, priests, and teachers—the profession of both his parents.

From an early age, Mateschitz showed an aptitude for selling an idea, like the time he persuaded his mother to let him attend university in Vienna rather than in nearby Graz. "I chose the university for the city, not for the university," he says. "But I could only find one course which wasn't available in Graz, which was ship construction. So I convinced her that I had only one desire in life, and that was to become a ship engineer."

It took him 10 years to get a degree in commerce from the Vienna University of Economics and Business, and he spent part of that time working as a ski instructor to pay the bills. After graduating, at 28, he spent 10 years as the international marketing director of a German consumer products company called Blendax. He was little more than a glorified toothpaste salesman, and by 38 he'd hit a wall. "All I could see was the same gray airplanes, the same gray suits, the same gray faces. All the hotel bars looked the same, and so did the women in them. I asked myself whether I wanted to spend the next decade as I'd spent the previous one."

A chance trip to Thailand in 1982 would prove to be the turning point in Mateschitz's life. Curious to know what attracted the locals to an uncarbonated "tonic" called Krating Daeng (Thai for "water buffalo"), he tried some himself and found that it instantly cured his jet lag. Not long after, while sitting in the bar at the Mandarin Oriental in Hong Kong, he read in a magazine that the top corporate taxpayer in Japan that year was a maker of such tonics. Suddenly, the idea hit him: he would sell the stuff in the West.



"It wouldn't be Red Bull," says Mateschitz, "if it didn't start out harmless and end up in catastrophe"

In 1984, Mateschitz approached one of his Blendax contacts, Chaleo Yoovidhya, a Thai businessman who was selling the tonic in Southeast Asia, and suggested that the two introduce the drink to the rest of the world, with one crucial change: It would be carbonated. Yoovidhya liked the idea, and they agreed to invest $500,000 apiece to establish a 49/49 partnership, with the remaining 2 percent going to Yoovidhya's son. (Yoovidhya remains a silent partner in the company.) Mateschitz then returned to Austria to plan the all-important packaging and slogan. For help, he turned to his university friend Johannes Kastner, who owned his own ad agency in Frankfurt.

"He said he had no money, so we agreed that he would do freelance work for me to pay me for it," says Kastner. Over the next year and a half, Kastner and his team put together about 50 different designs for Red Bull, with Mateschitz finally deciding on the distinctive blue-and-silver can emblazoned with the logo of two muscular bulls about to smash heads in front of a yellow sun. A slogan was harder to come by. "Nothing satisfied him, and I was finally so upset that I told him to find another agency," says Kastner. "He asked me to think about it for one more night. And at 3 a.m. it came to me—'Gives You Wings.' I called him right then and told him it was the last one I'd give him, but he said, 'That's it.' "

It was just what Mateschitz needed—something to convey that Red Bull had tangible effects. That, in turn, would allow his product-position-

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Red Bull's Wild World of Sports



BASE jumping
Red Bull-sponsored athletes frequently hurl themselves off cliffs wearing wingsuits, and wind up going viral on YouTube—whether they live or die

Snowboarding
To help Shaun White win gold in the half pipe at the 2010 Winter Olympics, Red Bull built him a secret training facility in Silverton, Colo.

Formula 1
F1 racing is a proven fast-track to financial ruin, but not for Red Bull, which boasts two winning teams and defending world champion Sebastian Vettel

ing master stroke: He would sell Red Bull as an ultra-premium drink in a category all its own. At about $2 a can, it was far-and-away the most expensive carbonated drink on the shelves. "If we'd only had a 15 percent price premium, we'd merely be a premium brand among soft drinks, and not a different category altogether," says Mateschitz. In 1987 he introduced the drink in Austria. Next came Hungary, the U.K., and Germany, and before long sales were spiking all over Europe.

At this point most histories of Red Bull tend to depart from Mateschitz and focus on Red Bull itself, which is exactly how he wants it. A curious hybrid of a mogul, Mateschitz has a zest for life that rivals Richard Branson's, but his obsession with controlling information puts him closer to Steve Jobs. Like the Apple chief, Mateschitz pulls the strings behind a consumer cult. And cults rely on message control.

While he's engaging in person, Mateschitz is notoriously secretive. (His elusiveness has prompted his staff to nickname him The Yeti.) He has a longstanding policy of refusing to discuss his private life, and until recently he wouldn't even consider answering questions about his only child, Marc, whose mother is a schoolteacher Mateschitz dated for two years.

He's close to some of Austria's most prominent people, though Mateschitz says he doesn't place a premium on collecting friends or socializing: "I don't believe in 50 friends. I believe in a smaller number. Nor do I care about society events. It's the most senseless use of time. When I do go out, from time to time, it's just to convince myself again that I'm not missing a lot." On those rare occasions, however, he invariably arrives with an attractive woman on his arm. "It's just that I'm not old and wise enough to be married yet," he says. "But is it necessary that you write about this?"

The success of Red Bull defies logic in one important regard: It doesn't taste very good. The amber-colored elixir's taste has been likened to "liquid Sweet Tarts" or "cough medicine in a can." (Although it does grow on you.) One early market research report in the U.K. put it bluntly: "No other new product has ever failed this convincingly." Mateschitz says he didn't care about the taste issue then, and he doesn't care about it now. "It's not just another flavored sugar water differentiated by color or taste or flavor," he says. "It's an efficiency product. I'm talking about improving endurance, concentration, reaction time, speed, vigilance, and emotional status. Taste is of no importance whatsoever."

But if Red Bull doesn't please the palate, what exactly does it do for you? The short answer is that no one outside of Red Bull is entirely sure. There's the caffeine content: 80 milligrams per can, twice that of a can of Coca-Cola and about the same as a cup of coffee. Those drinking original Red Bull and not the sugar-free version also receive a healthy dose of carbohydrates. But the rush Red Bull delivers is different from what you'd feel after drinking a coffee or two cans of Coke.

Enter the "crucial" ingredient: taurine, an amino acid found in meat, eggs, and human breast milk. While some studies have shown small doses of taurine to be beneficial against problems ranging from epilepsy to cardiac arrhythmias,

ILLUSTRATION BY CHUCK ANDERSON; PHOTOS: RED BULL CONTENT POOL (8)

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Soapbox Derbies

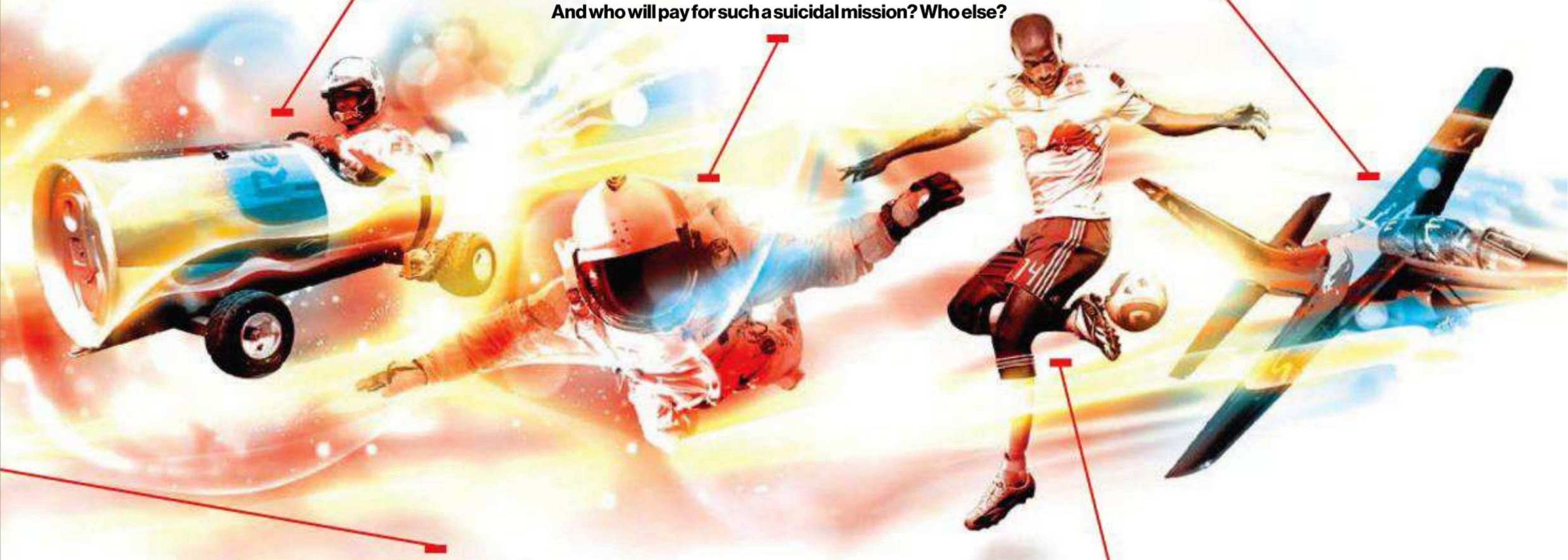
Deeply committed to motocross, Red Bull also stages races through city streets for gravity-powered vehicles, as it will on May 21 in L.A.

Vintage Airplanes

For seven years, Red Bull has staged its own air shows with races through towering, inflated pylons. They've been suspended for 2011 to improve safety

Sky Diving (from Space)

No one can say what will happen to Felix Baumgartner if and when the stuntman reaches the speed of sound while falling to earth from 120,000 feet. And who will pay for such a suicidal mission? Who else?



Print Publishing

The launch of a 1.2 million-circulation glossy—as magazines rush into iPad apps—may be the company's most extreme stunt so far

Soccer

Thierry Henry has helped lift the New York Red Bulls, who play in a brand-new soccer-only stadium, into first place

there's scant evidence of its impact on the body, positive or negative. A "non-essential" amino acid, it's manufactured from other amino acids in the liver, and scientists say it's therefore unnecessary to a healthy diet. But Mateschitz scoffs at this. "We have meters and meters of scientific evidence and support" showing its benefits, he says.

The company has shared the results of these studies with health authorities each time it has sought to enter a new country, and most governments have approved the drink for sale. It was banned, for a time, in both Denmark and France, where authorities were focused not on Red Bull's benefits but on the potential danger posed by its unusually high levels of taurine, caffeine, and certain B vitamins. In 1991 two young Swedes died on a night when they'd drunk Red Bull with vodka, and in 1999 an Irish teen who had consumed three Red Bulls died while playing basketball. Although investigators found no connection between the deaths and Red Bull, the cases raised alarms, as did a French study in which rats that had been fed taurine were found to exhibit bizarre behavior, including self-mutilation. Still, the data on taurine remains inconclusive.

Mateschitz proved his marketing genius, especially in an era of "crisis management," with his early decision to foster rumors about Red Bull's content instead of trying to quash them. In the early 1990s, when the drink emerged as a hit in the infamous all-night party circuit on the Spanish island of Ibiza, tales began to circulate that taurine was derived from bull testicles or even bull semen. The company let the gossip travel unchecked, and even set up a page devoted to the rumors on its website. "In the beginning, the high-school teachers who were against the product were at least as important as the students who were for it," says Mateschitz. "Newspapers asked, 'Is it a drug? Is it harmless? Is it dangerous?' That ambivalence is so important. The most dangerous thing for a branded product is low interest."

Was it all by design? Did he really anticipate that a combination of rumor and public outcry would play such a big part in driving early sales? Mateschitz is emphatic: "Yes. We expected it. It was a part of the strategy from the beginning. We would make the brand interesting enough that people wanted to get their hands on it."

Controversy aside, the central pillar of Red Bull's marketing campaign has always been its claim that it can improve athletic performance. To prove it, the company took a page out of Gatorade's book and targeted athletes, except that, in a timely twist, Mateschitz zeroed in on the extreme-sports crowd. The first athlete he signed up to be an "ambassador" was fellow Austrian Gerhard Berger, winner of 10 Formula 1 races. In short order, Red Bull was sponsoring events and athletes in a variety of perilous endeavors.

Today, Red Bull underwrites more than 500 athletes in 97 sports—100 of them in the U.S. But in a departure from the traditional sponsorship arrangement, Red Bull doesn't offer its athletes contracts, just a verbal agreement to "support" them in achieving their dreams. Some of those athletes don't need any "support" per se—Red Bull counts soccer star Thierry Henry and snowboarder Shaun White as part of its "family"—but some, like



"'Is it a drug? Is it harmless? Is it dangerous?' That ambivalence is so important"

Canadian ice-climber Will Gadd surely welcome the extra bucks.

The sports Red Bull tends to focus on are definitely not for the faint of heart. In the last 20 years, three Red Bull athletes–whom Mateschitz calls "family members"–have died in separate incidents: Shane McConkey and Ueli Gegenshatz (BASE jumpers) and Eli Thompson (Red Bull Air Force). "There are almost no sports within which mortal accidents are not a reality," Mateschitz says. "The sports they helped pioneer carry inherent risks which each would take with or without our support. And while we were hit hard by it and deeply concerned, they chose their journey long before we met."

Felix Baumgartner, the world's best-known BASE jumper, is in Mateschitz's inner circle, and his association with the company dates back to 1996. (BASE is an acronym for the fixed objects from which such athletes usually jump: Building, Antenna, Span–or bridge–and Earth.) Red Bull sponsors most of Baumgartner's stunts, such as a 120-foot leap from the arm of the Christ the Redeemer statue in Rio de Janeiro in 1999 that set the record for the lowest parachute jump in history. Baumgartner later admitted to Jay Leno that the idea sounded stupid. Leno replied, "It doesn't sound stupid. It *is* stupid."

Like everything else at Red Bull, the negotiations that lead to sponsorship deals are unorthodox as well. Windsurfer Robby Naish recalls his first meeting with Mateschitz almost 20 years ago. "We talked in the courtyard of his office in Fuschl, and pretty soon realized that we're both really into cars. That was the end of our business meeting, because he wanted to show me his Ferrari GTO. We went driving off into the mountains, and after 15 minutes he pulled over, got out, and told me to drive back. I didn't want to–it's a million-dollar car–but he said I was either going to drive the Ferrari or walk back. I was so scared, I drove like my grandmother."

The lines between Red Bull, Red Bull athletes, and Red Bull events are blurry on purpose. To Mateschitz, it's just one big image campaign with many manifestations. Americans might see 2005 Heisman Trophy winner Reggie Bush on television wearing a Red Bull hat. Or they might stumble on a YouTube video of Shaun White secretly training on the private half pipe built by Red Bull. Or they might actually attend one of dozens of global Red Bull events, like the May 21 Red Bull Soapbox Race in Los Angeles or a motocross spectacular in Brazil the week after. This is fun stuff, and it's a lot more interesting than writing a check to buy 30 seconds during the Super Bowl.

Despite the fact that he's approaching 70, Mateschitz maintains quite a clip. He still moves like an athlete, rides horses, pilots planes, and last year competed in an off-road motorcycle race. He has, however, installed a board of directors at Red Bull to work on broader strategic issues. Red Bull now has hundreds of competitors (the latest entrant: Tiger Blood energy potion, an homage to Charlie Sheen). For a time, there were rumors that Coca-Cola had offered to buy the company, but those have died down. Mateschitz has long insisted that he has no plans to sell or take Red Bull public. "It's not a question of money," he says. "It's a question of fun. Not only that, can you imagine me in a shareholders' meeting?"

The bigger question is whether the juggernaut he has built will survive him, factoring in that Red Bull is the vehicle for his passions and ideals. Mateschitz thinks so. And he even has a successor in mind. "My 19-year-old son will join the company after finishing his studies, if he wants to and if the time is right," he says.

Meanwhile, Mateschitz has certainly created some enviable havens for himself. Like Richard Branson, he has his own private island, the 3,000-acre Laucala, in Fiji. The flamboyant Malcolm Forbes bought the island for $1 million in 1972. Mateschitz heard about it from his friend George Harrison, the ex-Beatle, who had planned to buy the island himself before his death. In 2003, Mateschitz purchased it for a reported $10 million.

Laucala was first sighted in 1789 by Captain William Bligh of the *HMS Bounty* after he'd been relieved of his duties and set adrift by his mutinous crew. Mateschitz plans to use it mainly as a getaway for his small circle of friends, but he has also built an exclusive resort on the island. When I ask him what motivated him to buy a vacation home so far from Salzburg, he resorts to quoting Forbes himself: "He gave a nice answer, which was, 'Doesn't everybody want their own South Pacific island?' Well, in my case, he was right. I did." He also says that he has always been attracted to the idea of having his own independent state–the country of Red Bull, as it were–which would have the shortest set of laws in the world. "The rules would be simple. Nobody tells you what you have to do–only what you don't have to do." B

—With Ira Boudway

The view from Laucala, Mateschitz's private island in the South Pacific


LAUCALA: KLAUS LORKE NOLIMIT FOTODESIGN; RED BULL CONTENT POOL



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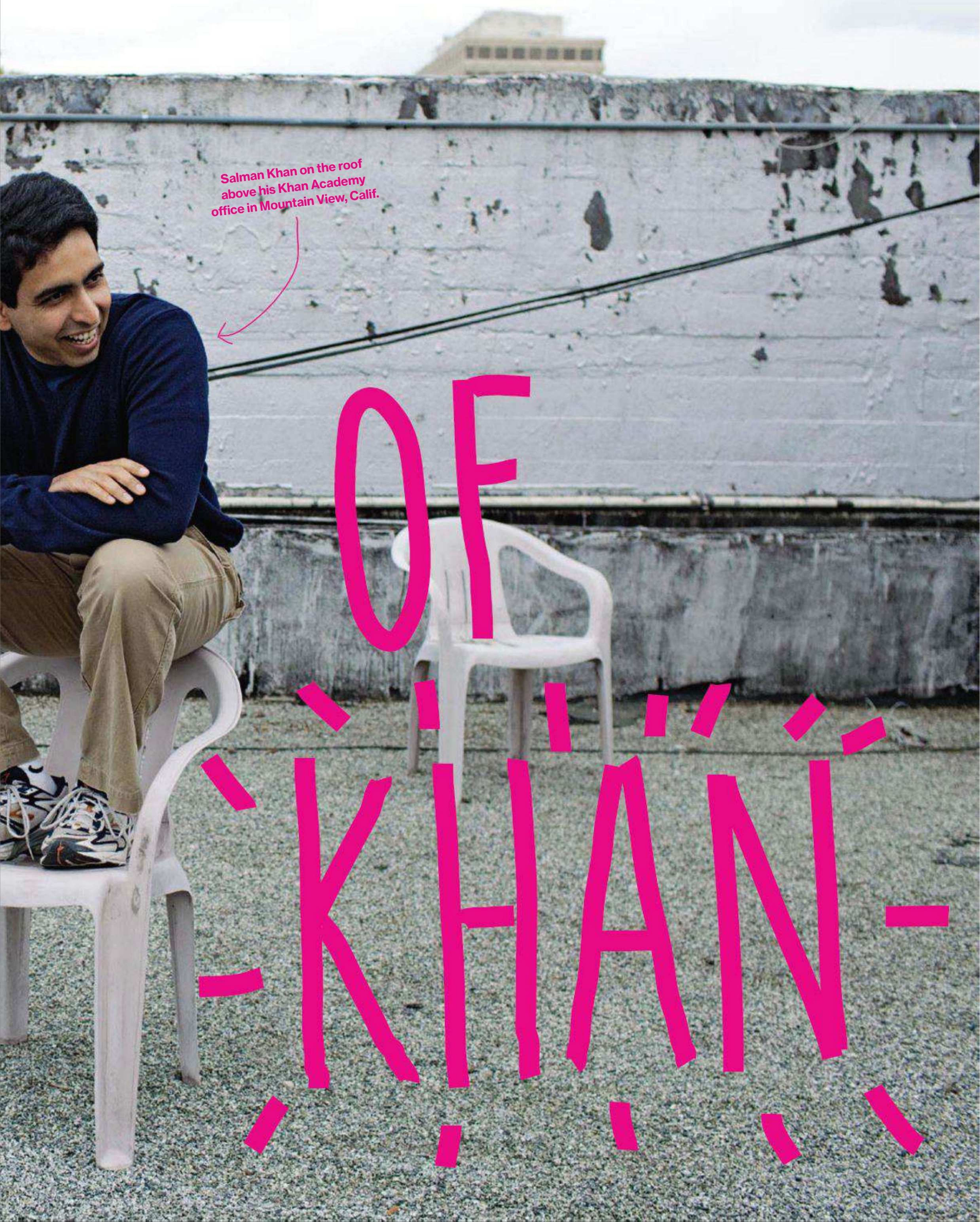
THE MATH

Can 1 ex-hedge fund guy + 2,300 YouTube videos = a revolution in American schools?

By Bryant Urstadt

Photographs by Alex Tehrani

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Salman Khan on the roof above his Khan Academy office in Mountain View, Calif.

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Khan at work on the latest of more than 2, 300 tutorial videos

In August 2004, Salman Khan agreed to help his niece, Nadia, with her math homework. Nadia was headed into seventh grade in New Orleans, where Khan had grown up, but she hadn't been placed in her private school's advanced math track, which to a motivated parent these days is a little bit like hearing your child has just been diagnosed with Lou Gehrig's disease. In particular, Nadia was having trouble with unit conversion, turning gallons into liters and ounces into grams.

Math was something Khan, then 28, understood. It was one of his majors at the Massachusetts Institute of Technology, along with computer science and electrical engineering. He had gone on to get a master's in computer science and electrical engineering, also at MIT, and then an MBA from Harvard. He was working in Boston at the time for Daniel Wohl, who ran a hedge fund called Wohl Capital Management. Khan, an analyst, was the only employee.

Being a bit of a geek, Khan put Yahoo!'s Messenger to work to help Nadia, using the Doodle function to let him illustrate concepts for his niece as they spoke on the phone. Then he wrote some code that generated problems she could do on a website. With Khan's help, Nadia made it into the fast track, and her younger brothers Arman and Ali signed on for Khan's tutoring as well. Then they brought in some of their friends. Khan built his site out a little more, grouping the concepts into "modules" and creating a database that would keep track of how many problems the kids had tried and how they had fared, so he'd know how each of his charges was progressing.

Messenger didn't make sense with multiple viewers, so he started creating videos that he could upload to YouTube. This required a Wacom tablet with an electronic pen, which cost about $80. The videos were each about 10 minutes long and contained two elements: his blackboard-style diagrams—Khan happens to be an excellent sketcher—and his voice-over explaining things like greatest common divisors and equivalent fractions. He posted the first video on Nov. 16, 2006; in it, he explained the basics of least common multiples. Soon other students, not all children, were checking out his videos, then watching them all, then sending him notes telling him that he had saved their math careers, too.

Less than five years later, Khan's sideline has turned into more than just his profession. He's now a quasi-religious figure in a country desperate for a math Moses. His free website, dubbed the Khan Academy, may well be the most popular educational site in the world. Last month about 2 million students visited. MIT's OpenCourseWare site, by comparison, has been around since 2001 and averages 1 million visits each month. He has posted more than 2,300 videos, beginning with simple addition and going all the way to subjects such as Green's theorem, normally found in a college calculus syllabus. He's adding videos on accounting, the credit crisis, the French Revolution, and the SAT and GMAT, among other things. He masters the subjects himself and then teaches them. As of the end of April, he claims to have served up more than 54 million individual lessons.

His program has also spread from the homes of online learners to classrooms around the world, to the point that, in at least a few classrooms, it has supplanted textbooks. (Students often write Khan that they aced a course without opening their texts, though Khan doesn't post these notes on his site.) Dan Meyer, a high school math teacher and Stanford University PhD candidate in education, puts it this way: "If you're teaching math in this country right now, then there's pretty much no way you haven't heard of Salman Khan."

Khan is more than just popular. He's a darling of America's amateur educational elite—people such as Bill Gates and John Doerr—who write checks and invite him to speak at their functions. Many of his followers are tech leaders, who understand more than most how dire America's standing in math education has become and what it may mean. In its 2010-2011 Global Competitiveness Report, the World Economic Forum ranked the U.S. 52nd in the quality of math and science education. Khan's March speech at TED 2011, the ideas conference in Long Beach, Calif., was met with an immediate standing ovation and capped by Gates, who interviewed him onstage about the project.

"I see Sal Khan as a pioneer," says Bill Gates. "It's the start of a revolution"

Gates is one of Khan's biggest fans. In early 2010 a staffer sent Gates a link to Khan's site, and Gates—a devotee of online learning with three children and a few billion earmarked to fund educational ideas—was immediately taken by it. He mentioned Khan in a speech at the Aspen Ideas Festival in July 2010 and soon after invited him up to Kirkland, Wash., where his think tank, BgC3, has offices.

"What Sal Khan has done is amazing," Gates says in a video on his personal website. "He's taken all this material and broken it down into little 12-minute lectures. I use it myself to remind myself of things. I have children who like it. So I was super happy he came up and we got to talk about where does he go now, and how can my foundation help him pursue this dream." The answer was a $1.5 million donation from The Bill & Melinda Gates Foundation. "I see Sal Khan as a pioneer in an overall movement to use technology to let more and more people learn things," says Gates. "It's the start of a revolution."

Google is also a supporter, having awarded the Khan Academy $2 million in September of 2010, when the Academy won a crowd-sourced contest called Project 10^{100}, which offered $10 million to five organizations that would "change the world." Doerr, one of the most successful venture capitalists of all time (Google, Amazon.com, Intuit) has, along with his wife, Ann, given $110,000 to the Khan Academy. "It's a little surreal to have your first donations by donors with a capital D like that," says Khan.

Khan moved to Palo Alto, Calif., in 2005, where he worked on Khan Academy videos out of a closet in his home. This spring he set up headquarters over a tea shop in Mountain View. It's a down-to-earth Silicon Valley town that, thanks to Google, its most famous corporate resident, has lots of people with the means and inclination to underwrite Khan's experiment. On a visit in April, the new office was nearly empty, save for a few desks and three of eight employees, including Shantanu Sinha, the chief operating officer, who had left consulting firm McKinsey to join Khan. There were numerous large ficus trees and a few framed photos leaning against the walls; Khan had just ordered them from Art.com.

Khan's own office had only a handful of tablets like the Wacom sitting on a desk made out of remilled telephone poles and

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a bookshelf with a smattering of textbooks and science fiction paperbacks, which Khan reads for fun. A few days before, he had hosted Wael Ghonim, the Google employee who helped spark the revolution in Egypt. He was off to visit Reed Hastings, the chief executive officer of Netflix, later in the week. (Hastings recently pledged $3 million.) A Charlie Rose taping would follow the week after that.

Between meetings and appearances, Khan took a little time to describe where the Khan Academy had been and where it was headed. In the first years, Khan's hedge fund job started early and finished at 2 p.m. (the office worked on East Coast time), and he spent the afternoons making videos and building the site's analytical tools. These tools have since blossomed into a full-featured dashboard that tracks each student's progress, showing which modules have been completed, how a student has done on the practice questions, which videos a student has watched, and how much time a student has spent watching those videos. It has since been modified so that a teacher or "coach" can pull up a list of dozens of students whose progress can be compared, module by module. A student with a lot of greens is cruising along. Yellow bars indicate that a module isn't finished. Red signifies trouble. These are all linked to a "knowledge map" that records which modules have been completed and also how the modules relate to one another, so a student can pick a path from addition to derivatives.

By September 2009, Khan had left the hedge fund but was still working in his closet and had essentially turned himself into a full-time producer of amusing and helpful math shorts that were going viral. He wasn't getting paid, but he was being approached by a number of venture capitalists.

"They would say, 'Hey, let's do a hybrid double bottom line organization,'" says Khan. "Meaning you care about profit and social good. There would be this big equity chunk. There might be a freemium model. You'd get a salary. It was funny, too, because they think you're this person who doesn't care about money at all. They're like, 'It's for the love of the kids!' But I do care about money. I was tempted, but by meeting two it had become not fun for me."

In the end, he wasn't and still isn't sure the Khan Academy should be a business. Because it's a nonprofit, it's able to attract all kinds of talented dreamers, many of whom work for free. "We're getting talent money can't buy," says Khan, mentioning the newly hired Dean of Open Source John Resig, an expert in the Java programming language. Giving away his curriculum means Khan doesn't have to tailor it to states such as California and Texas, which, by wielding enormous ordering power, end up shaping textbooks for many other states. The California Education Dept., for instance, reviews its math curriculum about every six years, though even that schedule is the subject of legal wrangling. The document describing just an "overview" of the process of textbook approval and adoption is 12 pages long. These adoptions are categorized as "opportunities" by New York-based McGraw-Hill, a major textbook publisher, which tracks them closely.

"What you have in most education software is that they're catering to the decision-maker who makes the budget allocations, and that decision-maker has a lot of check boxes," says Khan. "Does it do this? Check. Does it do that? Check. They could care less about the end user experience. We're very bottom up. The for-profit guys, as soon as they incorporate, they start lobbying for grants and selling into school boards and become essentially dependent on navigating this huge bureaucracy, and they completely lose sight of the end user. It's the opposite of what we're doing."

Khan survived on donations and savings until the spring of 2010, when he got an e-mail from PayPal saying that someone had just put $10,000 into his account. It turned out to be from Ann Doerr. He wrote her his thanks and said that since she was his largest donor, he would love to name a school building after her, if the Academy had a campus. A lunch followed, and Doerr expressed shock that she was Khan's biggest donor. She put a check for $100,000 in the mail, insisting that he take a salary. More important than the money, she has become a cheerleader for the Khan Academy and often stops by the office.

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Stills from videos on the French Revolution, calculus, finance, and biology



"Sometimes," says Khan, "she even brings cake."

Overtures from the VCs have since tapered off. "They get that the Khan Academy is not for profit, which is part of the reason I think it's working," Khan says. "We have volunteers and so much good will. It's not a religious thing, it's just that some things are better in the not-for-profit world."

Giving away effective methods for mastering the world's knowledge presents a Napster-like challenge for companies such as London-based Pearson and McGraw-Hill, which publish two of the most popular grade-school math textbooks and offer extensive online and digital components. For Pearson, the education segment in North America, comprising textbooks, online products, and test administration, represented £2.6 billion ($4.2 billion) worth of business in 2010; for McGraw-Hill in 2009, it was $2.4 billion. Education Market Research estimates that the K-12 textbook market alone will reach $3.5 billion in the 2010-2011 school year.

Companies such as Pearson and McGraw-Hill do more than create education material, though. They've also mastered the art of selling to the bureaucracy. Pearson offers the Envisionmath student textbook for $64.97 and piles on dozens of aids, worksheets, and digital options. There's the Classroom Manipulatives Kit ($427.47), which has fake money, color tiles, and other learning tools; and there's a massive selection of CD-ROMs, in formats like the Digital Teacher Resource Package ($997.47), the Premium Digital System Teacher Resource Package ($2,047.47), and the Professional Development Series Package ($1,187.47). McGraw-Hill's offerings are similarly varied and just as expensive. Mike Evans, head of the math curriculum at Pearson, says schools don't necessarily opt for all of those. "Close to no one buys the $2,000 package," he says. "We estimate the total cost per student is usually about $10 to $12 per year."

Not surprisingly, McGraw-Hill and Pearson are also building online offerings and have separately contacted Khan about some kind of partnership. Khan did end up contributing some videos to a forthcoming book on chemistry by Cengage Learning, another player in the education market, doing problems from the book. Most of these talks have gone nowhere for the simple reason that Khan wants his stuff to be free.

On a Thursday morning at the Covington Elementary School in Los Altos, Calif., fifth-grade teacher Richard Julian has put aside Pearson's Envisionmath textbooks (special California version) for a morning with the Khan Academy. Covington is one of three schools in the Los Altos district using the Khan Academy in some fifth and seventh grade classes. It's also the kind of school every parent dreams of. The buildings are bright and clean, the grounds are carefully maintained, and the weather is so good that the students hang their bags on the walls outside the classroom.

Julian's classroom has windows on three sides and room for his desk as well as a separate lectern. Inside, 27 children sit in front of 27 laptops, all logged on to the Khan Academy. Used in the classroom, the Khan Academy flips the traditional curriculum; students listen to the lectures at home, on their own time, and do the homework in class, which allows the teacher time to address student issues individually. As the class progresses, Julian wanders through the desks with an iPad running Khan's dashboard, so he can see who's ahead and who's behind. He doesn't really need it: He already knows exactly how each student is progressing. And he isn't doing as much individual teaching as one might expect. Often, the lagging students are tutored by the students who are ahead. "The kids know whom to call on," says Julian. "It happened on its own. They just began to get out of their seats and work with each other. They've identified their trustworthy peer tutors. They know they can call on Sriram and Akhil and Albert, and that they know what they're talking about. Mainly, I've had to spend time teaching them how to teach."

Erin Green, principal of Covington, loves the Khan Academy and plans to expand it to more classrooms. "Many of the students are working at a level of mathematics that I have never seen in an elementary school before, maybe not even in a junior high school before," she says. "They're engaged and they're excited, and that's the most exciting part. It meets you at your level."

The Khan Academy has also been introduced in two seventh-grade classrooms for struggling learners in the Los Altos district, and the district is considering using it in all schools next year. "Their improvement has been dramatic," says Khan of the slow group, who notes that his studies are small, not peer-reviewed, and just intended for him to get a sense of whether Khan Academy methods are working or not. "We're seeing 70 percent on average improvement on the pre-algebra topics in those classrooms. It definitely tells us it's not derailing anything. All the indicators say that something profound looks like it's happening."

In Julian's class, Sriram, one of the standouts, is asked what he's working on.

"Chains," he responds. "It's like a calculus thingy. But it's really easy."

"Well, to him," says Julian.

Sriram moves aside. The question on his screen looks like this:

$f(x) = e\cos(x)$
$f'(x) = ?$

Along the right side are five answers:

○ $e(\cos(x)) - 1 \cdot (\tan(x))$
○ $(e - (\cos(x)))\cos(x) \cdot (\csc(x))$
○ $(\cos(x)) \cdot e\cos(x) + (\sin(x))$
○ $e\cos(x) \cdot (-\sin(x))$
○ None of these.

Sriram explains in a halting, impossible-to-understand fashion how he arrives at the answer, plugs it in, and gets a "correct."

"I don't get some of this stuff either," says Julian. "They're like, can you help me? I'm like, I have to go back and watch Salman's videos." **B**

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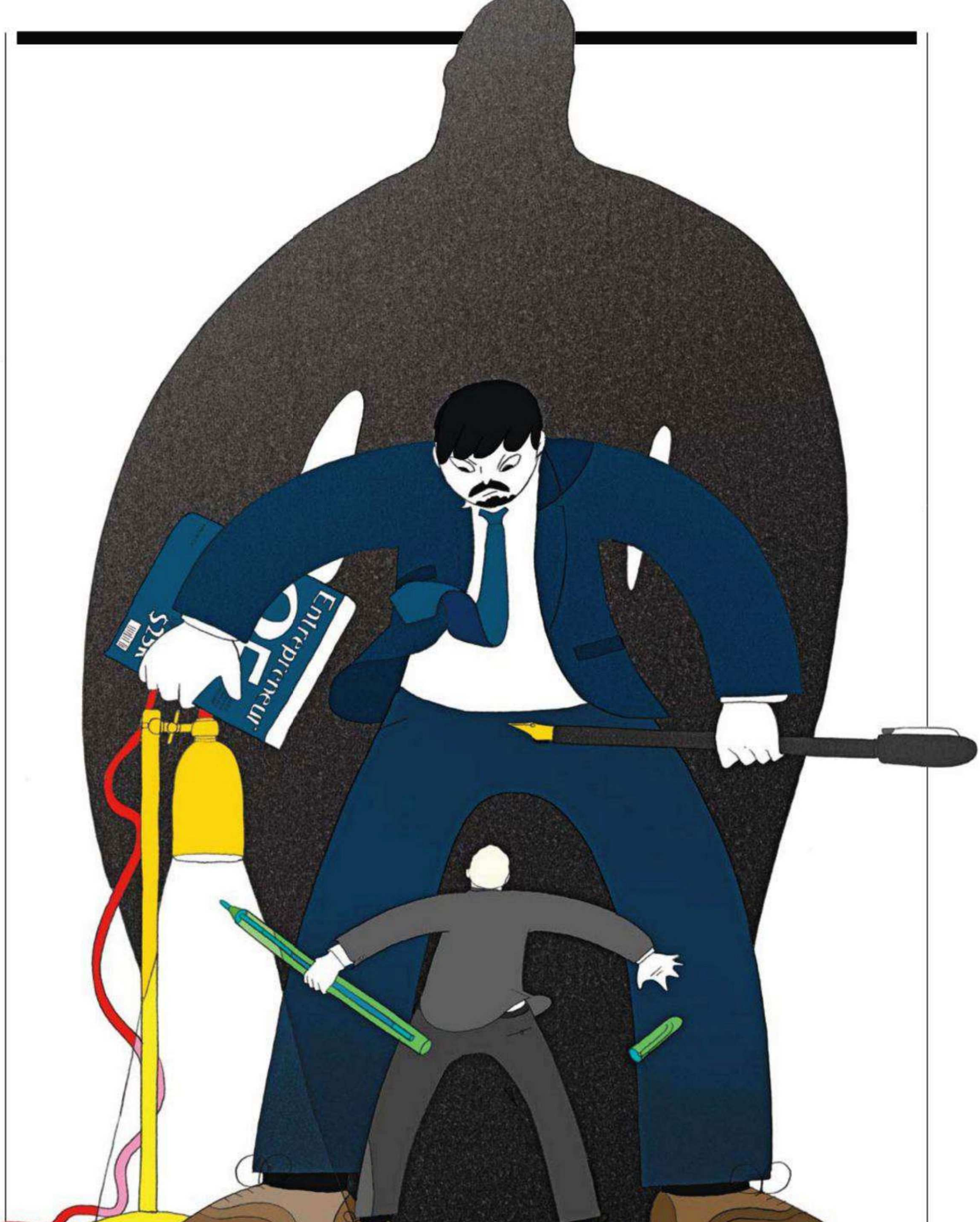


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ENTREPRENEUR, THE MAGAZINE THAT SUES ENTREPRENEURS

The curious case of Entrepreneur Media Inc., which never rests in its quest to nurture —and afflict—other startups.

By Paul M. Barrett
Illustrations by Celyn Brazier

Entrepreneur Media Inc. sells the idea of the self-made little guy getting ahead. Based in Irvine, Calif., EMI, as the company is known, publishes *Entrepreneur*, a monthly magazine with a circulation of 607,000 and a colorful history. According to newspaper reports, the periodical's founder and former owner, Chase Revel, once tried robbing banks for a living. Today, EMI conducts seminars revealing "business success secrets" of a more mainstream nature. It markets instructional CDs and sells advertising to package deliverers, health insurers, and franchisers such as Wahoo's Fish Taco restaurants. In other words, EMI caters to all things entrepreneurial. Strangely, it also smashes the dreams of the self-starters it aims to serve. ¶ Daniel R. Castro, a serial entrepreneur in Austin, Tex., received a stern letter from EMI's lawyers last September ordering him to "cease and desist" using his new website, EntrepreneurOlogy.com. In his day, Castro, 50, has started a law firm, a mortgage company, and a real estate-lending outfit. He employs a half-dozen people full-time and coordinates the work of a platoon of brokers. He also delivers motivational speeches to other business owners and hopes the new website will provide an online home for a workshop series. "I was dumbfounded," he says of the cease-and-desist letter. Like a lot of people who work for themselves, he doesn't like to be told what to do. "Their problem," he says of EMI, "was that they didn't know who they were picking on."

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An attorney with the corporate law firm Latham & Watkins informed Castro that EMI owns the U.S. trademark for the word "entrepreneur." With 2,000 lawyers in 31 offices around the world, Latham polices EMI's intellectual property aggressively. The firm even instructed Castro to surrender his domain name to EMI. "If you fail to abide by these demands," the letter said, "Entrepreneur Media will have no choice but to take appropriate action to prevent continued use of an infringing mark and domain name."

The archetypal trademark—for McDonald's or Xerox, say—prevents competitors from using a distinctive word that might cause consumers to assume they were buying a product made by the mark holder. To Castro and others, "entrepreneur" seems different. "How can you trademark a commonly used word, derived from the French, that's hundreds of years old?" he asks. And more to the point, "why would the publisher of *Entrepreneur* magazine be bullying entrepreneurs?"

Since the early 1980s, EMI has sued or threatened to sue scores of businesses and organizations it claims infringed its trademarks. EMI won't provide a tally of its targets, but it almost always prevails.

Scott Smith, a public-relations man in Sacramento, Calif., fought back and paid the price. A federal judge ruled in 2003 that he had to drop EntrepreneurPR as his firm name, stop publishing a quarterly compilation of press releases called *Entrepreneur Illustrated*, and pay EMI more than $1 million in damages and attorneys' fees. "They crushed me, and I had to file for personal bankruptcy," says Smith, who is still contesting what he owes the publisher.

EMI goes after a broad spectrum of businesses, ranging from Internet startups to a fledgling clothing manufacturer. In 2001 it persuaded the nonprofit Donald H. Jones Center for Entrepreneurship at Carnegie Mellon University to change the title of its quarterly alumni newsletter, *The Entrepreneur*. In 2004 it stopped 3Entrepreneurs, a San Diego apparel company, from putting the phrase "Entrepreneur Generation" on T-shirts, sweaters, and hats. At present, EMI is skirmishing with the Entrepreneur Hall of Fame and Museum, a one-man website based in Glen Cove, N.Y., with aspirations of someday occupying a brick-and-mortar facility. "*Entrepreneur* is the enemy of entrepreneurs," says the hall of fame's proprietor, Mitch Schlimer, who began his career selling New York-style soft pretzels from a street cart with his grandfather.

Demonized by those it pursues, EMI's legal strategy benefits from the momentum of a larger judicial trend. "The point of federal trademark law is to prevent consumer confusion," explains Mark A. Lemley, an intellectual property scholar at Stanford Law School. "In recent decades, though, courts have expanded the idea of consumer confusion so much that you have businesses like Entrepreneur Media stifling other, smaller businesses whose goods or services just aren't likely to interfere with consumers making well-informed decisions." In EMI's case, the professor adds, "it's particularly ironic because the trademark holder is in the business of helping the kinds of people and businesses it's suing."

EMI sees no irony, let alone bullying. In an e-mail, the company's lead attorney at Latham, Perry J. Viscounty, says his client "vigorously enforces its trademark rights in appropriate circumstances, when a third-party use is likely to cause confusion in the marketplace." In a separate letter, the company adds: "EMI has been forced to take action against individuals, small businesses, and large businesses." EMI asserts that the action against apparel maker 3Entrepreneurs was appropriate because the publisher has also produced clothing with its trademarked "entrepreneur" logo. "EMI has taken no action against unrelated applications and uses," the company continues, pointing to the example of Brother International's use of "Entrepreneur" on sewing machines. Viscounty notes that Bloomberg LP, owner of *Bloomberg Businessweek*, also "has a history of taking action, where appropriate, to protect its rights when consumer confusion is likely." He ticks off several examples, including *Bloomberg LP v. Bloomberg Mortgage*, a successful suit filed in federal court in New York in 2002, and ongoing efforts to protect the company's Bloomberg Launchpad trademark for computer programs and software.

While Viscounty is correct that many intellectual property owners enforce their rights to the fullest extent of the law, the comparison with Bloomberg or any other corporation has a flaw: Unlike EMI, most companies don't make a practice of suing the very people they hope to attract.

Chase Revel, who started *Entrepreneur* in the early 1970s, was a leading purveyor of goods and services related to the swift acquisition of wealth. His published works include *184 Businesses Anyone Can Start and Make a Lot of Money* and *168 More Businesses Anyone Can Start and Make a Lot of Money*. Revel's ideas ran the gamut from the seductive and legal to the nefarious and illegal. In 1966 he was sentenced to four years in prison under his given name, John Leonard Burke, for attempting to rob four banks in Houston in one day, according to articles published 20 years later by the *Los Angeles Times*. Revel (then Burke) hired helpers to deliver letters warning bank tellers that their children had been kidnapped. (Revel researched which employees had school-age kids.) The notes stated that the children would be returned only if the tellers surrendered large canvas bags stuffed with cash. In fact, no children had been snatched, and the scheme collapsed almost immediately.

Settling in Los Angeles after his release, Revel started *Entrepreneur* and, in 1979, registered the trademark for "entrepreneur." He promptly began to enforce the mark—for example, by having his attorney send a cease-and-desist letter to the Entrepreneur Assn. at the University of California's Graduate School of Management in Los Angeles in November 1980. In 1987, Revel sold a majority stake in *Entrepreneur* to an investor group led by businessman Peter J. Shea and later offloaded the rest. The trademark went along with the magazine.

After moving on to other pursuits, Revel continued to have scrapes with the authorities. As recently as 2006 he denied wrongdoing and paid $27,500 in a settlement of civil allegations by the Federal Trade Commission that

"How can you trademark a commonly used word ... that's hundreds of years old?"

Not to be confused with the sewing machine



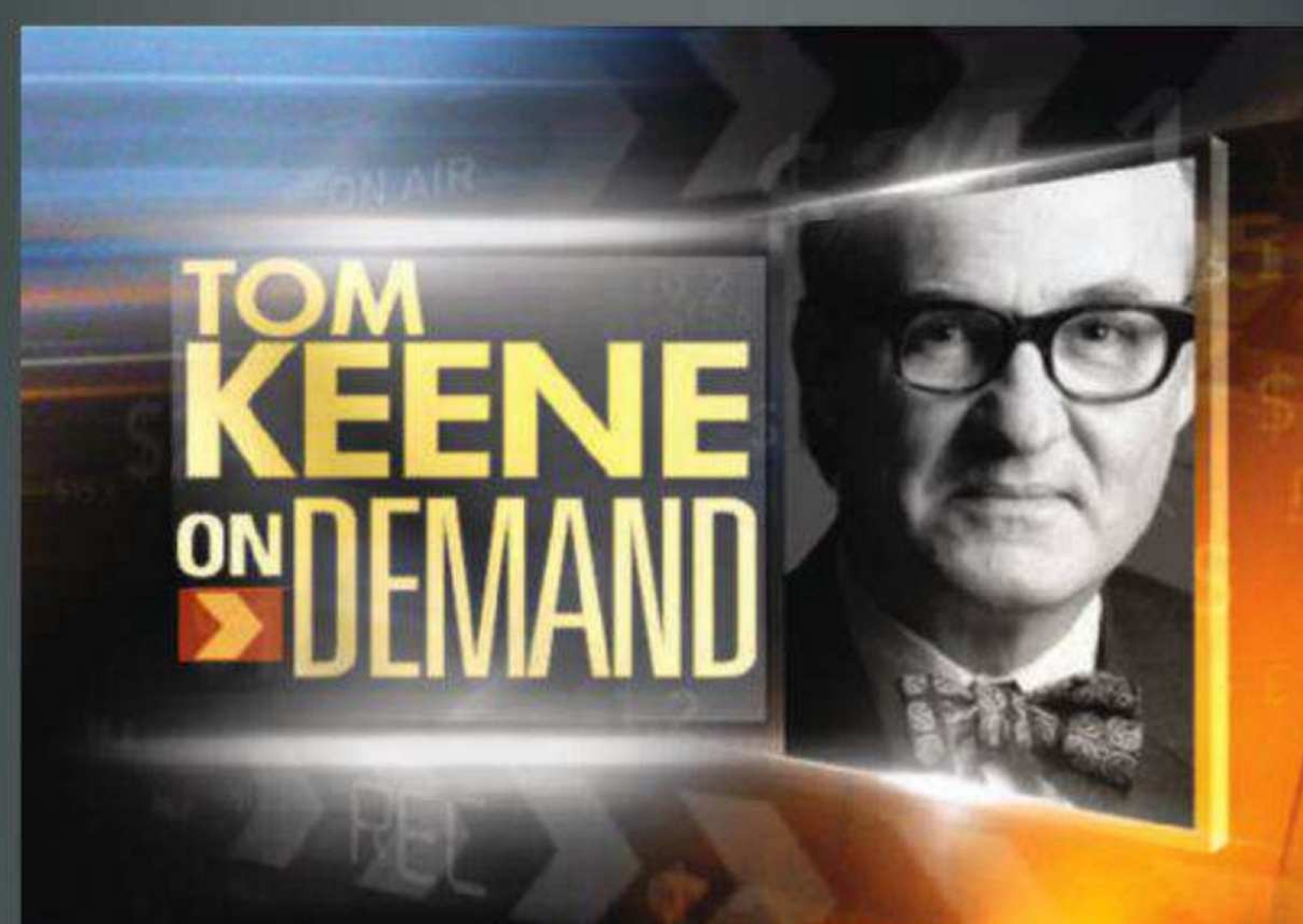
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he created false advertising for Gero Vita dietary supplements. According to public records, Revel, now 74, owns a home in Oceanside, Calif. A man who answered the phone there hung up immediately, and a message went unreturned.

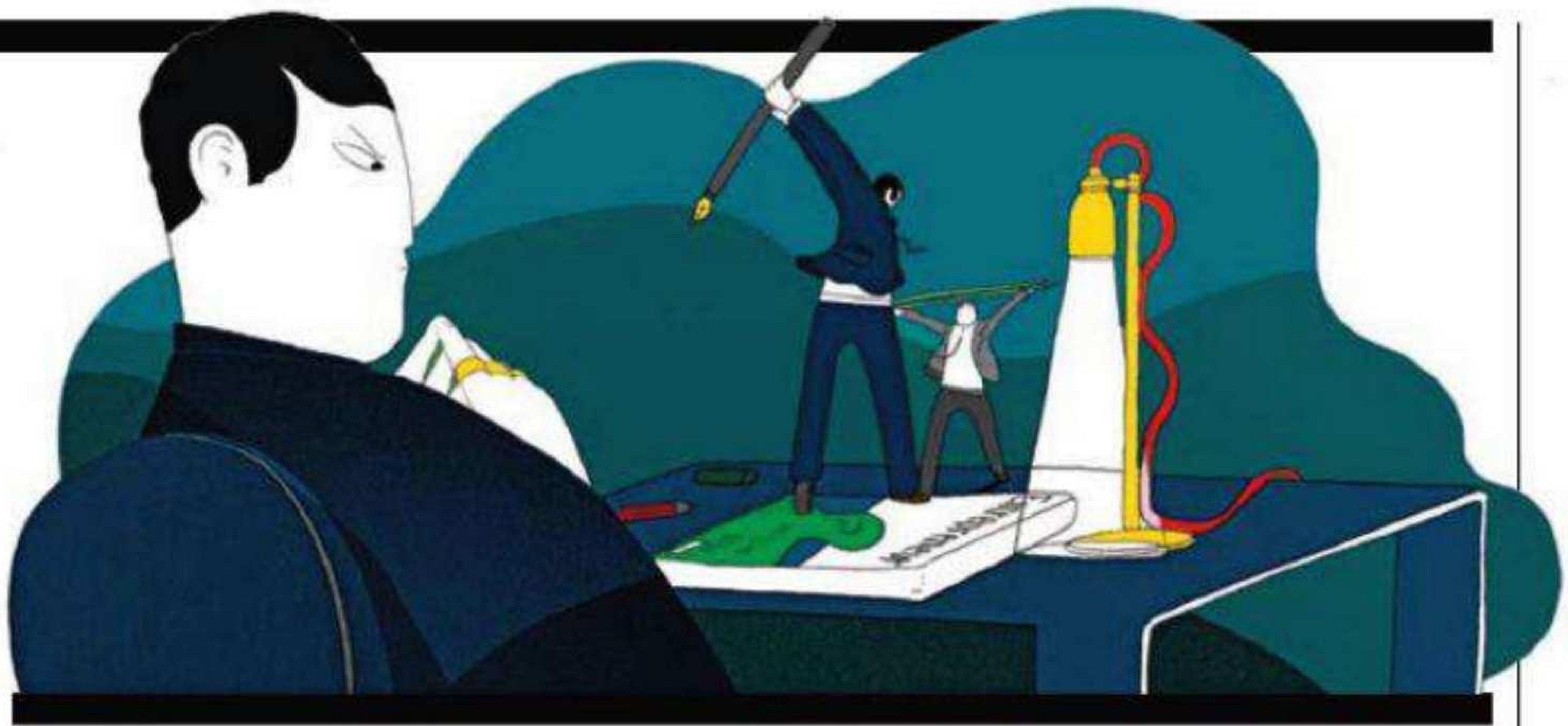
In its letter, EMI asserts that "while Mr. Revel has an interesting history, he and his alleged actions have no relevance to EMI's operations or efforts to enforce its intellectual property rights." Revel, the company adds, "has had nothing to do with, and no contact with, EMI for almost 30 years." Shea, the company's current owner and chief executive officer, has no desire to talk to "a competing publication" about his magazine's distant past or its trademark enforcement policies, the letter states. In an interview with the magazine *World Trademark Review* in 2009, Shea, who earlier made a fortune marketing a simulated version of stained glass, said: "Basically, we're trying to protect our brand."

Smith, the Sacramento public-relations man, counters that EMI protects its brand by rolling over tiny capitalists and using lawsuit damages as a source of income revenue. He presents himself as the quintessential victim of what he calls EMI's maltreatment. "There's no way my little firm representing small businesses would be confused with a national magazine," he complains. "This is a scam."

The federal courts disagreed. In 2003 a U.S. district judge in Los Angeles found that both Smith's company, EntrepreneurPR, and *Entrepreneur* magazine "printed publications geared for small businesses." Testimony showed that some of Smith's clients "were under the mistaken belief that there was an affiliation between *Entrepreneur* and EntrepreneurPR," the judge added. In 2004 the U.S. Court of Appeals for the Ninth Circuit in San Francisco affirmed the ruling of willful infringement. Smith has changed the name of his company to BizStarz, laid off his half-dozen employees, and works out of his home.

"Smith's own actions caused the demise of his business," EMI says in its letter. "Rather than focusing his remaining resources on his rebranded company and half-dozen employees, Smith squandered the company's time and money on an ill-advised appeal."

"There's no way my little firm...would be confused with a national magazine. This is a scam"



Castro, the Austin real estate broker, also doubts anyone would mix up his website EntrepreneurOlogy.com with *Entrepreneur*. "I mean, how is 'entrepreneurology,' a word I have to admit you can barely pronounce, going to cut into their business?" he asks. EMI's main website is entrepreneur.com. It also has a Spanish-language site called entrepreneurenespanol.com.

In addition to selling residential real estate, Castro has a law license and courtroom experience. He responded to EMI's cease-and-desist letter by preemptively suing the publisher in federal court in Austin. "It was Castro who leapt to litigation," says EMI. In April a federal judge dismissed 12 of Castro's 14 claims but said he could continue to pursue his allegation that EMI's core trademark is invalid. As described in his court papers, Castro's argument is that "the public has not come to associate the word 'entrepreneur' exclusively with EMI's products or services." The word, he adds, "is a generic noun that is in the public domain."

"Generic" is a crucial term of art in intellectual property law. A judicial determination of generic status ordinarily dooms a trademark. Even distinctive marks that become generic can lose their legal protection; cellophane and aspirin are but two examples.

EMI argues in its court filings in Austin that "Castro's entire argument miscomprehends and misstates" trademark law. In connection with business media, "entrepreneur" is not generic, EMI contends; it has acquired "secondary meaning," another term of art that refers to a seemingly ordinary word that has come to be associated with a particular company's products. "Time," for example, has been trademarked to identify a magazine, even though the word also refers to hours and minutes, EMI maintains. Castro can make use of "entrepreneur" in its descriptive sense ("Hello, my name is Daniel Castro, and I am an entrepreneur"), but he may not use the word as the name for a communications business, EMI says.

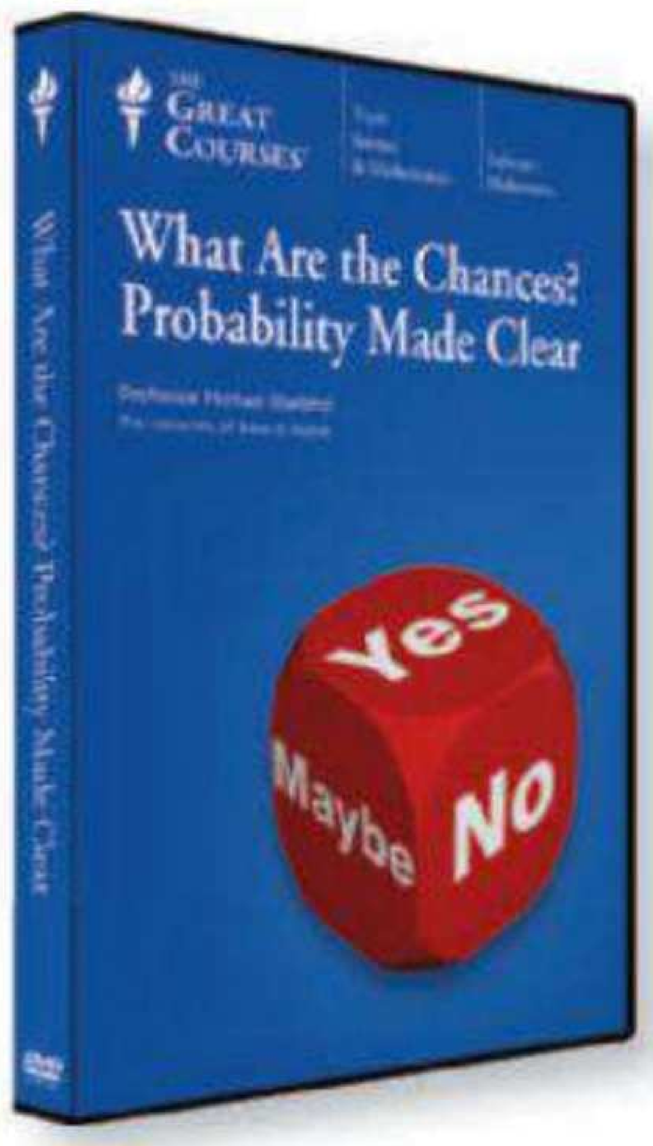
To prevent a trademark from deteriorating, cellophane-style, into a generic term, courts encourage mark holders to protect their interests. "EMI has the right and obligation to police and enforce its trademark rights, or risk diminishing or altogether losing those rights," the company argues in its court papers.

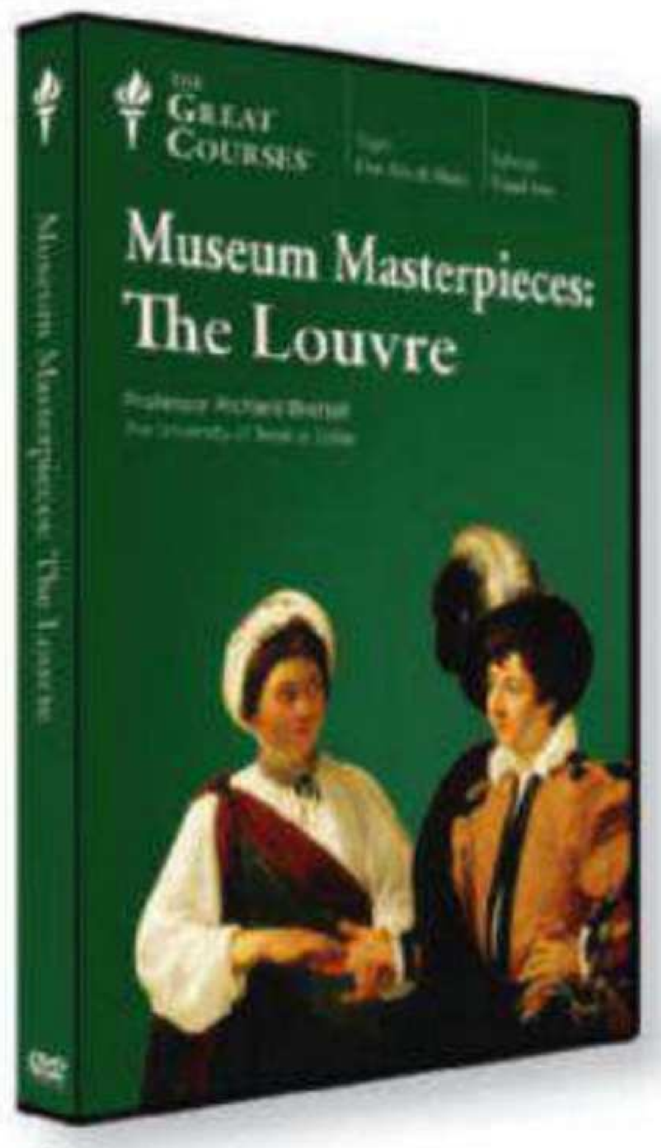
In the litigious precincts of intellectual property, the aggressor inevitably finds itself chasing its own tail—and EMI and its lawyers have actually tried to use the "generic" argument to their advantage. In 2008, Ernst & Young, one of the Big Four accounting firms, sued EMI in federal court in New York, alleging that the publisher violated its trademark for an Entrepreneur of the Year award. The dispute over the prize dates to 1994, when Ernst first sent EMI a cease-and-desist missive aimed at *Entrepreneur*'s similarly named award. EMI fired back in a lawsuit in California that Ernst's award trademark cannot be infringed because "entrepreneur of the year" is a generic term. In the end, Ernst and EMI settled their differences confidentially and out of court. EMI changed its award name slightly (nominations for "*Entrepreneur Magazine*'s Entrepreneur of 2011" are now open), while Ernst is celebrating the 25th anniversary of its trademarked Entrepreneur of the Year program.

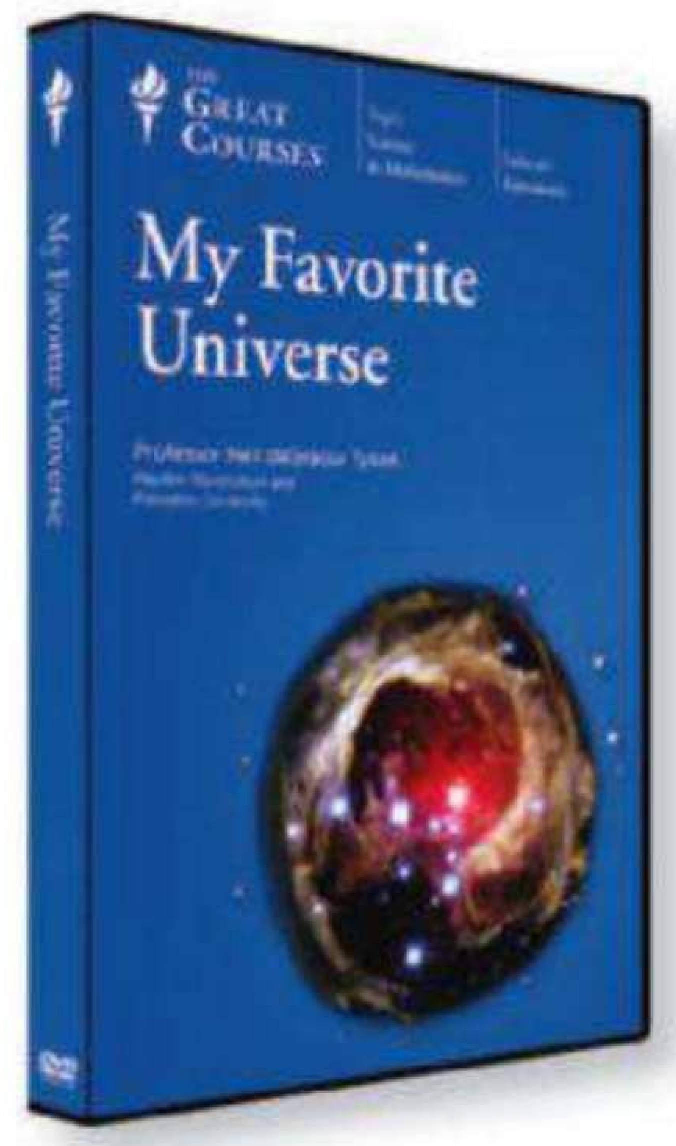
This year, as in years past, the real winners don't even have to enter. They are the many lawyers who profitably stoke the perennial flames of intellectual property antagonism. They may not be entrepreneurs, but EMI has certainly bulked up their bank accounts.

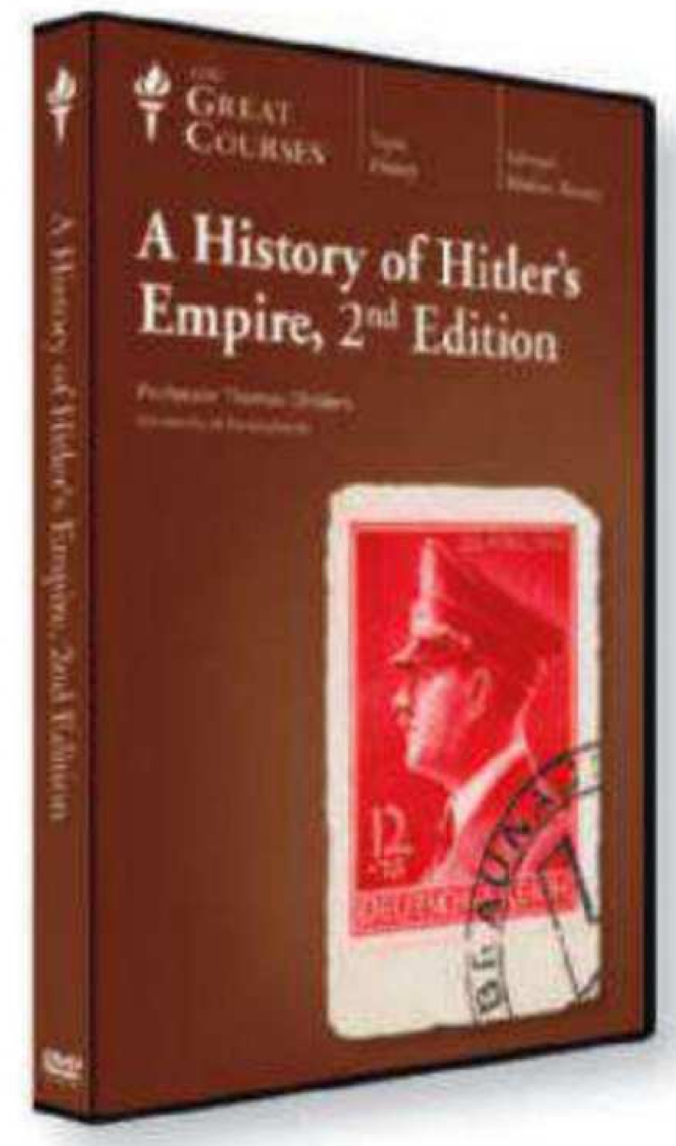
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The butlering trade is enjoying a renaissance page 90

Mansers&Futbol&Dick Fuld Goes Nuts!

Etc.

Finding the perfect summer work dress page 88





Welcome to the Real World, Kids

At KidZania theme parks, children play at being grown-ups—and companies market to them as if they are. *By Dana Rubinstein*

Photograph by Chris Floyd

TOP: PHOTOGRAPH BY NICK FERRARI FOR BLOOMBERG BUSINESSWEEK

WorldMags

Etc. Edutainment



López expects up to 20 million annual KidZania visitors by 2013



Children fascinated by oral hygiene (and who isn't?) or just eager to play with a dummy's teeth (ditto) can visit the Malo Clinic at KidZania in Lisbon



Though it doesn't pay a lot, many KidZanians are drawn to firefighting. It lets them ride child-size fire trucks, wield fake hoses, and extinguish real-looking flames

When Antonio Ribeiro found himself with two restless children in a Portuguese beach town, he did what any desperate parent would do: He went for the leaflet rack in the hotel lobby. There he found a brochure advertising something called KidZania—a sprawling indoor theme park, attached to a Lisbon mall, where children could pretend to be nurses, dentists, runway models, photographers, radio announcers, window cleaners, and countless other professions. And so Ribeiro ventured to KidZania with his 4-year-old twin girls. They burped fake babies in a pretend maternity ward. At a miniature dentist's office, they examined a dummy's teeth. They had a rollicking good time. "The whole concept—to play being an adult—seemed so attractive," says Ribeiro.

This role-playing Xanadu is the brainchild of a childless 47-year-old former private equity guru. An unlikely pioneer of the "edutainment" business, Xavier López Ancona launched KidZania after managing bottling companies and airport suppliers for GE Capital. When a friend asked him to invest in a small chain of day-care centers—where kids would play in make-believe supermarkets, banks, and hospitals—he had an epiphany. "That's where the spark started," recalls López, "Nobody *owns* role-playing."

At least until now. In 1999, López opened the first KidZania in the Santa Fe neighborhood of his native Mexico City. "The first year, it just blew by all of the metrics for the attendance numbers, for the number of sponsors, for the satisfaction of the guests," says Cammie Dunaway, KidZania's global chief marketing officer. "So he decided to franchise the concept." The second KidZania opened seven years later in Tokyo, and the business has since spread to seven other cities including Dubai, Jakarta, Lisbon, and Seoul. Each park is a miniature city in which children "work" in up to 100 pretend businesses, from dental clinics to fire stations and bottling plants to courier services. Ten more KidZanias are now under construction in places such as Kuala Lumpur and Santiago. In 2013, López plans to open a park in an as-yet-to-be-determined U.S. city, the first of what he says will be at least 12 across the country. By that same year, he estimates KidZanias the world over will attract up to 20 million annual visitors.

As his edutainment empire has expanded, a fine-tuned business model has emerged. First, find an urban metropolis in a climate where people will pay money to come indoors. Second, make sure said metropolis has an abundance of young families and a concentration of corporate headquarters. Third, persuade said corporations—especially those with sizable corporate social responsibility budgets—to pay KidZania to build branded, role-playing establishments inside "cities" scaled for children. In Lisbon, Portuguese paint company CIN sponsors a house where children—wearing red smocks and face masks—paint walls. In the Sony studio—the company is a partner in five parks—they can learn to be photographers. At KidZania Mexico City, Procter & Gamble soap Safeguard sponsors the Safeguard pavilion, where a mascot encourages children to wash their hands—and develop a lifelong devotion for the brand. "The objective is to teach the children the correct hand-washing process," explains P&G spokeswoman Ana Ramirez. Asked whether P&G also sees the pavilion as a way to develop future customers, she says, "Yes, definite-

"The first year, [KidZania] just blew by all of the metrics for the attendance numbers"

KIDZANIA: PHOTOGRAPHS BY CHRIS FLOYD FOR BLOOMBERG BUSINESSWEEK (4)

OTHER UNLIKELY (BUT REAL) THEME PARKS



At **The Holy Land Experience** in Orlando, visitors can travel back to Biblical times and hang out with "Jesus"



Dickens World in Kent, England, allows visitors to revel in the merriment of 19th century industrial London



In this pretend spec house, sponsored by Portuguese paint giant CIN, children dress up in red, paint-splattered smocks. Maybe it's more exciting in person



At the corporate logo-emblazoned Johnson & Johnson infirmary, children don scrubs and play with the innards of a dummy. It's like a life-size version of Operation

ly." Explains Ramirez, "We hope they buy Safeguard products once they're grown up."

Coca-Cola, which is a partner with KidZania in five locations, insists it's not marketing to children. "[W]e do not advertise our products in children's programs," says Luis Fuentes, a company spokesman. "We do not target children under the age of 12 with any of our brands' marketing messages." Instead, the company operates kid-size bottling plants, where, Fuentes says, children can learn "what it is like to be in charge of the production line." The process, he says, helps teach children how "to ensure consumers get the best experience through Coca-Cola products."

Creating such experiences has become very profitable. KidZania makes about a third of its money from marketing deals, says López, who refuses to consider them a form of advertising. "KidZania is not an advertising medium," insists López, who, as proof, points to one of KidZania's founding documents. "One of 16 ethics we have is that [KidZania] has to be reality-based. When children do role-playing, it has to be close to reality!"

"When children do role-playing, it has to be close to reality," says KidZania founder López

This devotion to role-playing verisimilitude is apparent upon arrival, at kiosks where parents buy their children "plane tickets" to KidZania. (In Mexico City, it's American Airlines; in Dubai, it's Emirates.) Tickets range in price depending on the market, from about $15 in Mexico City to around $45 in Tokyo. Kids also get a check for 50 kidZos, the local currency. One of their first stops, naturally, is at a bank, where they're encouraged to open an account. Deposited kidZos accrue interest.

The next stop is often a job information center, where they can take quizzes to determine what they'd enjoy doing for a pretend living. Then the eager children are unleashed into the high-production-value wonderland of make-believe. Not only do parents pay for their kids to pretend to work, but—in a simulacrum of the real-world economy—children also get paid to pretend to work. In something of an inverse relationship to reality, though, less popular jobs (set designers) pay slightly higher wages than popular ones (firemen). Kids can improve their pretend life (and earning potential) by getting bachelor's, master's, and doctoral degrees, each of which requires a 20-minute class and a quiz. After an exciting day of career-enhancing make-believe, children can redeem kidZos for merchandise.

It gets even more elaborate. Within each KidZania, citizens are called KidZanians, and they speak KidZanian. They address each other as Miss or Sir; say "Kai," for hi (the word is accompanied by two fingers over the heart); "kal" for pal; and "Z-U," for "see you." Every KidZania has a "government," involving the adults who run KidZania and a group of local children who meet once a month to workshop the activities in a focus group. "I just came back from Seoul last week," says Dunaway, who, in addition to her global CMO title, is known in KidZania-speak as President of the United States. "I don't know a word of Korean, but I walk around the park, and we all say 'kai' to each other."

Dunaway, who was poached last year from Nintendo, is so enthusiastic about the KidZanians that she's now busy building out virtual edutainment parks. "I think there are going to be any number of ways to extend the KidZania brand and experience," she says. "The opportunity to extend into video games, into cartoons, movies, books, role-playing materials—I think all of that is well within grasp." Ⓑ



At **Jeju Love Land** (on Jeju Island, South Korea), 140 sculptures graphically depict various sexual acts. It's educational



Grūtas Park, in Grūtas, Lithuania, remembers Stalinism with a 1.2-mile-long sculpture garden and a recreated gulag



Suoi Tien Theme Park in Ho Chi Minh City is an homage to the Buddha—complete with a water park and a crocodile farm

Etc. Fashion

Work It, Women

These summer work dresses prove that the office doesn't have to be boring

By Naomi Kaplan



THE TRENDSETTER

Striking a balance between elegant and playful, this poppy-hued dress from **Porter Grey** is the best way to hit all the season's trends: bold color, sheer cap sleeves, and an accordion-pleated skirt. *$450; shopbop.com*



SEA SUITE

The nautical stripe—a summer staple—is updated in dress form by the Finnish fashion house **Ivana Helsinki**. For a more formal look, wear it with a wide belt. *$300; Leifsdottir.com*





PLAYING IT COOL

A quick fix for the over-air-conditioned-office plight is the three-quarter sleeve. **Tibi's** silk and viscose shirtdress comes with a removable leather belt for a billowy or a more polished look. *$458; tibi.com*



THE PREPSTER

The classic preppy shirtdress by **Tory Burch** is freshened up in navy and accented with gold buttons. With wedges or flat sandals, the overall effect is clean and sporty yet professional. *$350; toryburch.com*

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IN LIVING COLOR

For a splash of color, **Rachel Roy's** silk faille dress has an asymmetrical hem and flutter sleeves. It has the look of a wrap dress without the hassle of wearing one—making it perfect for work. *$595; neimanmarcus.com*



THE GRAY LADY

Gryphon New York gives a standard gray sleeveless frock an update with neon-yellow contrasting trim and slit pockets. The universally flattering cinched waist offers instant shape. *$250; bergdorfgoodman.com*



FIRST RESORT

Embrace the maxi-dress trend with this printed piece from **Alice + Olivia by Stacey Bendet**. Pair it with platform sandals for an alternative to the ubiquitous minidress. *$440; aliceandolivia.com*



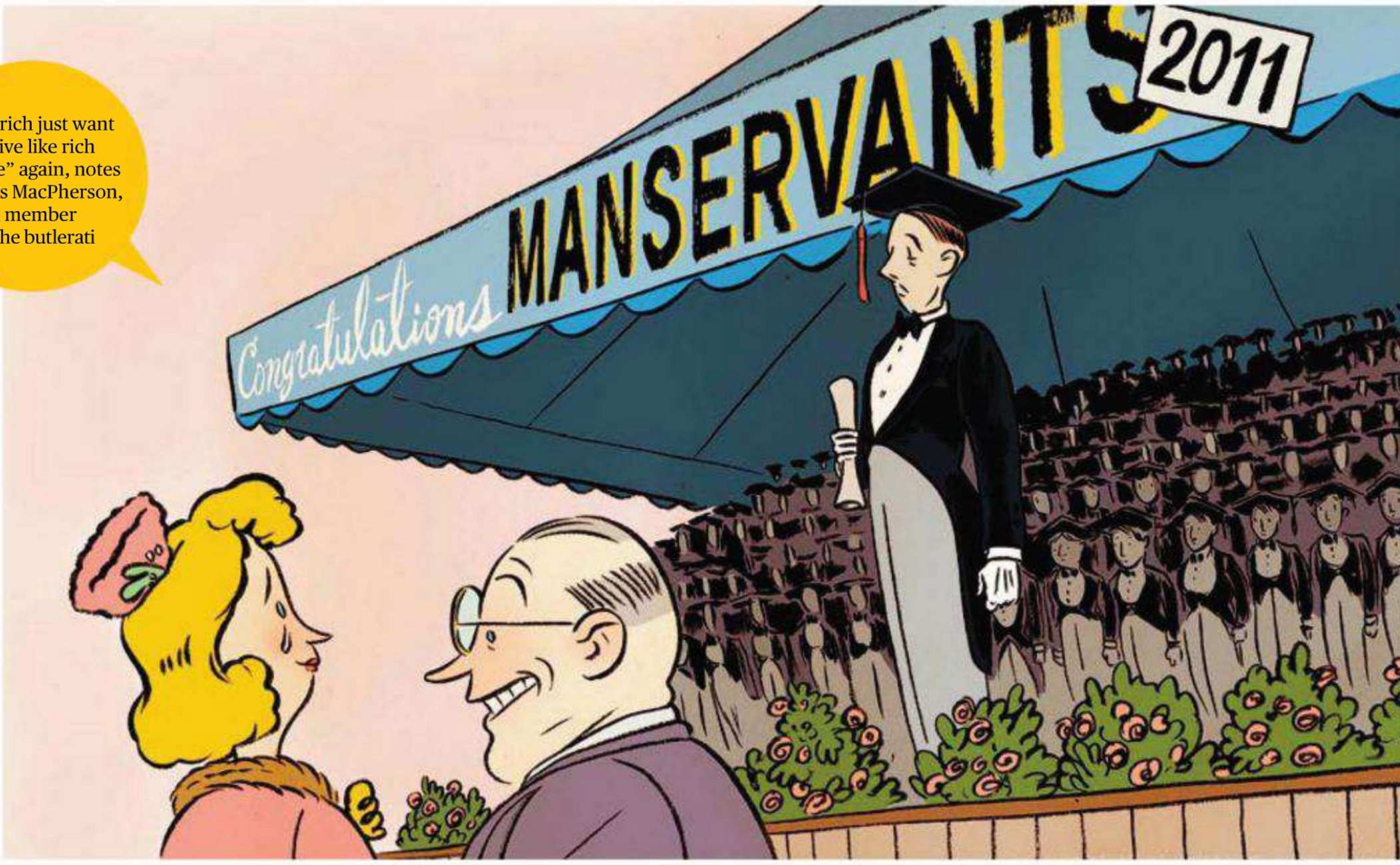
MIDCENTURY MODERN

Socialite and art collector Peggy Guggenheim's eccentric style inspired this **Milly** cotton jacquard dress. The scoop neck shows an office-appropriate amount of skin while a belt lends sophistication. *$395; millyny.com*

PHOTOGRAPHS BY NICK FERRARI FOR BLOOMBERG BUSINESSWEEK

Etc. Branding

"The rich just want to live like rich people" again, notes Charles MacPherson, a member of the butlerati



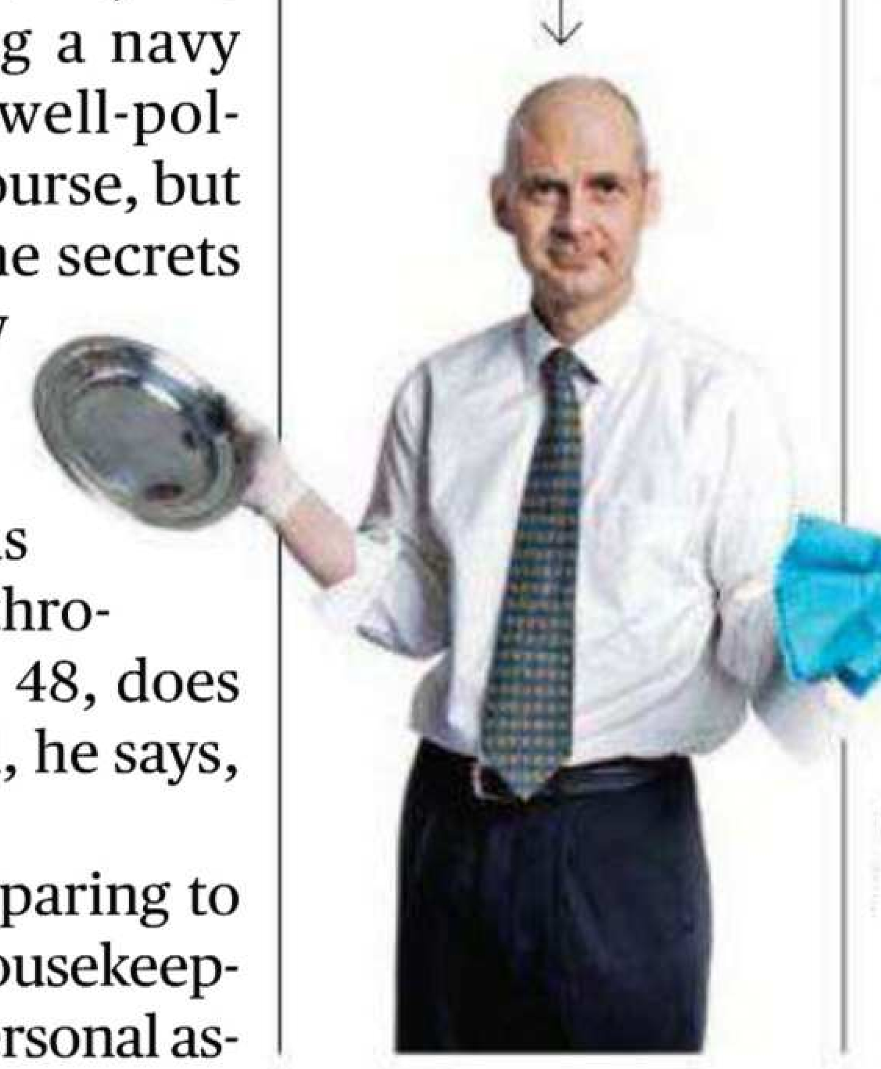
The Right Staff

The butler industry is enjoying a rebirth—and benefiting Big Help entrepreneurs. *By Max Abelson*

Christopher Ely is prone to philosophizing about his life's work. "You should be invisible, to a certain point," he explains carefully, wearing a navy blue pinstriped suit and well-polished shoes. "You *exist*, of course, but you *don't*." Ely, of course, is describing the secrets of the manservant trade. As one of New York's most famous butlers, he's enjoyed a storied career that began as a footman at Buckingham Palace and led to a job as the butler and estate manager for philanthropist and power widow Brooke Astor. Ely, 48, does not use the term "manservant." The word, he says, "has such connotation to it."

This is one of the many tips Ely is preparing to pass on to the next generation of butlers, housekeepers, chauffeurs, governesses, housemen, personal assistants, laundresses, and chefs. This week he and Manhattan's French Culinary Institute inaugurate the Estate Management Studies program. Tired of hearing people tell him, "We couldn't get good staff," Ely says, he set out to reinvigorate the entire domestic-service industry with a curriculum that combines its ancient hallmarks—efficiency, decorum, and discretion—with what the institute calls the "contemporary skills necessary to manage modern-day residences."

Star butler Christopher Ely is trying to reignite the service business by teaching a $1,750 course on doing the laundry

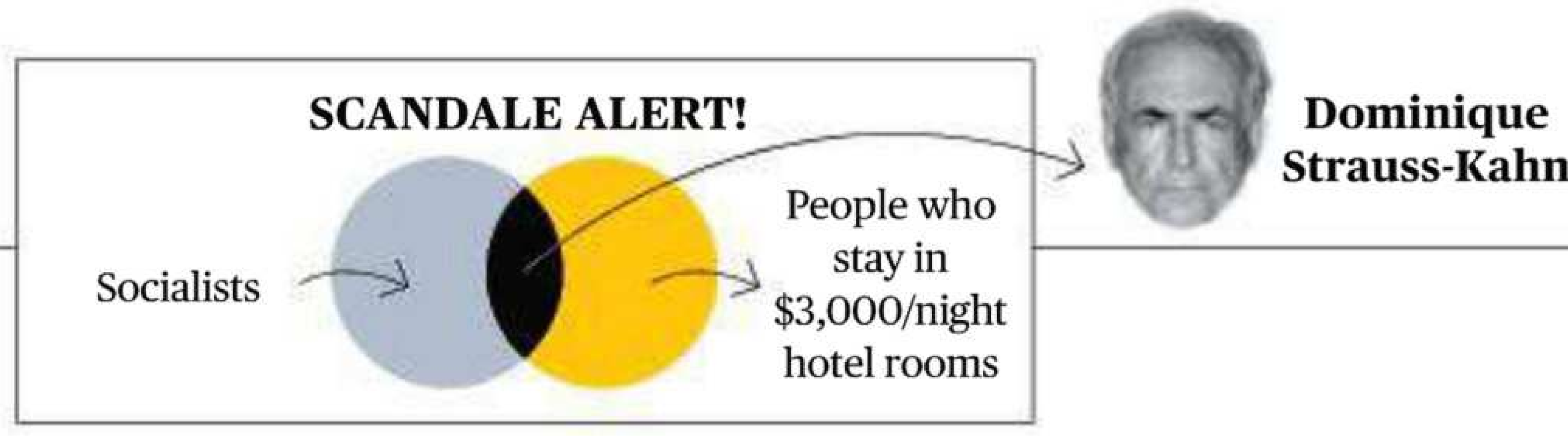


Ely and FCI founder and Chief Executive Officer Dorothy Cann Hamilton have already developed courses on laundry, household cleaning, and the "practice of being a private chef"—25 hours and $1,750 each—in addition to a $1,995, 30-hour "culinary essentials" tutorial. Ely believes he can enlighten and "elevate" his students through his intimate knowledge of linen steaming, towel folding, seafood canapé preparation, and the all-important butlering tenet: invisibility. "It's not like a waiter in a restaurant that's bothering you every two seconds," he says firmly. In all, the FCI is planning a 12-course curriculum.

It also expects a regiment of willing pupils. After a recent hiccup, the help business is on the rise.

THIS PAGE, ILLUSTRATION BY ZOHAR LAZAR; ELY: PHOTOGRAPH BY ERIN PATRICE O'BRIEN FOR BLOOMBERG BUSINESSWEEK; OPPOSITE PAGE, ILLUSTRATIONS BY MATT OWENS/VOLUMEONE; STRAUSS-KAHN: PETER FOLEY/BLOOMBERG

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"It's incredible," says Keith Greenhouse, CEO of the Pavillion Agency, a New York staff placement firm. In the first quarter of 2011, he says, Pavillion received 487 job orders, compared with 283 in the same period in 2009. Through the agency, one young family is looking for someone to "work for both Mr. in his business and Mrs. at home" and "respond to the family's needs at odd hours." A "formal Park Avenue family" wants a cook who can clean silver. The CEO of a fashion house needs a "formally trained housekeeper" to supplant the live-in nanny. According to Ely, a "good" butler should command a salary of about $80,000 a year.

The resurgence of rich people has triggered a rebirth elsewhere in the industry. "When we hit last summer, that's when all of a sudden the economy really changed. And so by the time we were into September of last year, the placement orders went through the roof. It was like, 'Oh, my God,'" says Charles MacPherson, founder of Charles MacPherson Associates, a Toronto-based butlering academy and placement agency. "People just needed to move on," he says, "and start living their lives again." MacPherson isn't alone in his gratitude for rich people remembering just how rich they are. "From September 2008 until January or maybe even February 2009, I doubt that I made a placement. Not one," says Mary Louise Starkey, president of Starkey International Institute for Household Management in Denver. Starkey, whose organization refers to her either as "Mrs. Starkey" or "the First Lady of Service," says her 2011 first-quarter revenues have "darn near close to doubled" over the same period last year.

This is particularly heartening in light of Mrs. Starkey's recent history. In 2007 the First Lady of Service was the subject of stories in Denver's *Westword* newspaper saying she'd been accused of a physical altercation with a former student. Charges against her were dismissed, Starkey says, and she compares the bad press to Martha Stewart's. Ultimately, says the First Lady, it did "not affect the trust my clients have in me." However, when such unpleasantness arises, members of Big Help can turn to trade organizations such as the Domestic Estate Managers Assn. in Grosse Point Farms, Mich.–the Toastmasters of butlering. It charges $49.95 per year in dues under the motto, "Serving Those Who Serve Others." And, as with the rest of the service market, Vice-President Mike Wright says his industry is bouncing back.

All this growth, however, has Ely concerned about the industry's future. "Look at some of these Wall Street people," he says. "Their life starts to expand. And what a lot of them tend to do is get a maid who's looking after somebody else in the building." Maid referrals, he explains, sometimes come from doormen. "So they get this one, and then that one. Then maybe they upgrade, or they want somebody else for the weekend," he says. "But they're not really well-qualified, full-time sort of people, do you know what I mean?"

Tired of hearing, "We couldn't get good staff," Ely has developed a butlering master curriculum

This failing concerns Cann Hamilton, too. "One of the most amazing things is that people on Wall Street think about assets," she says. Yet they "sit there and say, 'O.K., I have a housekeeper. I don't care if she ruins my drapes or if she ruins my sheets.' Is that penny-wise and pound-foolish?"

Ely believes it is. Standing in the halls of the FCI, his shirt is impeccably laundered–he favors Borax and OxiClean ("marvelous") and dishwashing liquid for the collars and cuffs. According to his syllabus, Ely's laundry course will teach how to "protect buttons and embellishments against damage and deterioration" and to "freshen clothes without washing them." It will show students "the latest organic alternatives," the "fine principles of hand washing," and "the basics of flat drying and boxing delicate garments."

Those tips may help Ely's graduates find work in the current landscape, where, as MacPherson says, "the rich just want to live like rich people." Ely also believes employers may send their current staff to Estate Management Studies for a touch-up. He understands this sort of insatiable quest for butlering perfection. "You want them to do more. You want them to do it better," he says. "I would have people come work with me at Astor's, and then I would show them: 'No, I want it done *this* way.'" B

Clean Living

Christopher Ely's tips for maintaining a respectable household



1. Bedmaking

After your master wakes up, leave the bed unmade and uncovered for at least half an hour. Do you want his overnight perspiration to become trapped, potentially attracting all manner of insects? Heavens, no!



2. Furniture washing

When cleaning a sofa, one should always use distilled and deionized water. Tap water contains lots of minerals–including iron. If you add such minerals to a nice pale fabric, it will be even trickier to remove the stain.



3. Suit cleaning

A bespoke suit *can* go to the dry cleaner but *must* be pressed by the tailor. To avoid confusion, tell the cleaner: "Clean, but don't press"–then take it to the tailor. This may seem cumbersome, but one's lord will be pleased.



4. Help hiring

Choosing secondary help isn't like hiring someone to watch your kids–it has consequences! If you hire somebody at minimum wage, they'll look after your master's things minimally. And that would be dreadful.

WorldMags

Forty percent of ZocDoc's bookings occur 24 hours before the appointment time



No Scrubs

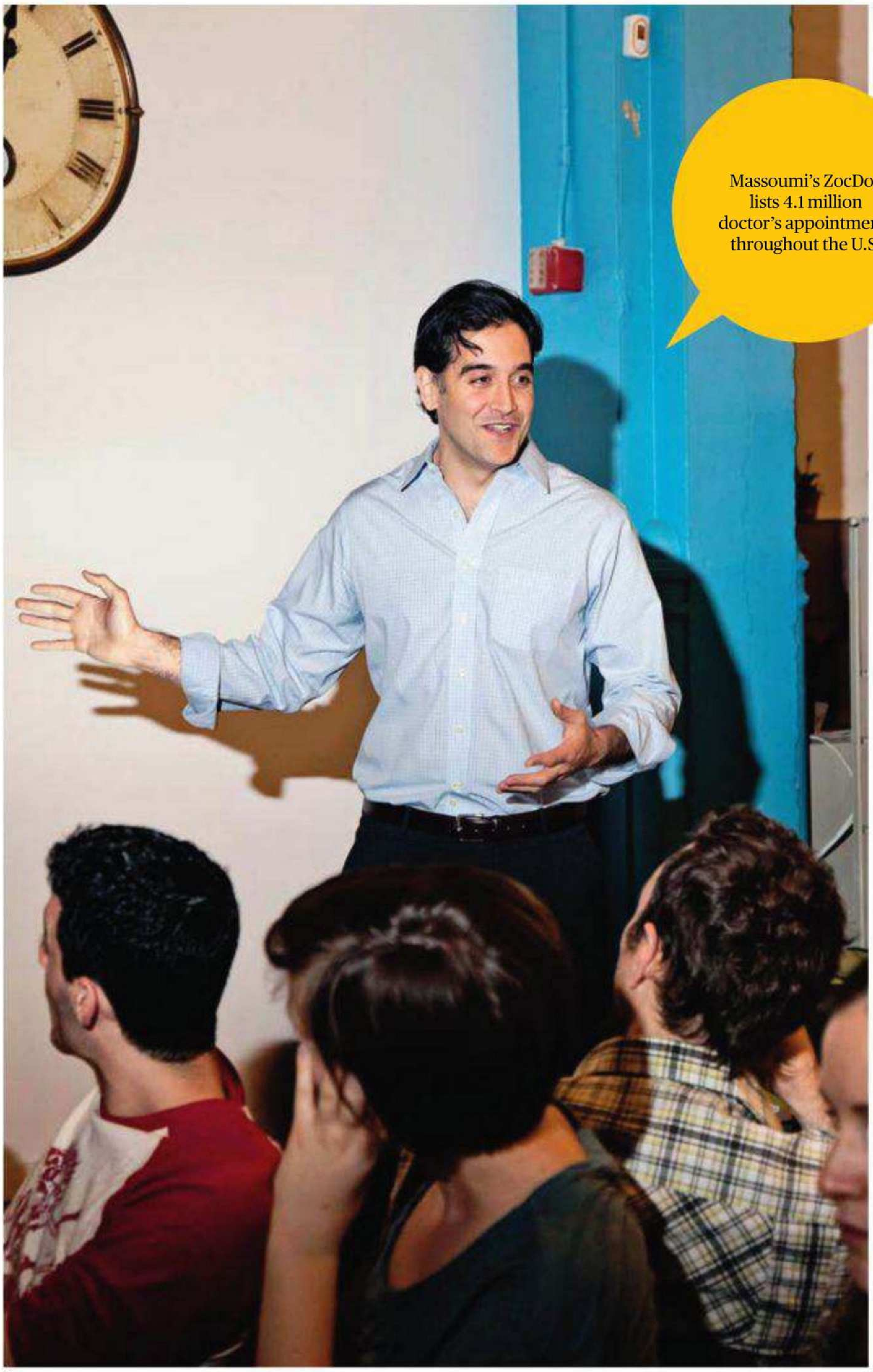
A medical emergency inspired a McKinsey consultant to create a health-care business

In 2007, Cyrus Massoumi was flying home to New York after a business trip when he ruptured his eardrum. The McKinsey consultant needed to see an ear-nose-throat specialist immediately, but it took him three days to even find a doctor. Massoumi couldn't believe the holdup: If he could book a dinner reservation online, he thought, why not a doctor's appointment? That's when he came up with the concept for ZocDoc, an OpenTable for medical appointments.

A couple of months later, Massoumi, now 34, took a sabbatical and recruited two partners to experiment with his idea. They beta-tested the concept with New York dentists, under the assumption that Web-savvy young people visit dentists more often than they see physicians. The site quickly generated 5,000 appointments, and Massoumi quit his day job. In late 2007 they launched ZocDoc.

While some health-care professionals were initially hesitant, they soon came to appreciate the site. Since 40 percent of ZocDoc's bookings occur within 24 hours of an appointment, doctors found the service helpful in attracting new patients and filling canceled slots. Today, ZocDoc lists more than 4.1 million appointments for dentistry, primary care, dermatology, OB-GYN, and other services. The site, which is free for patients and charges doctors an average of $250 per month, has a base of 500,000 monthly users and has expanded to Chicago, Dallas, Houston, Los Angeles, San Francisco, and Washington, D.C. Massoumi has helped raise $20 million in venture capital and now oversees some 100 employees. Massoumi's ambition has also grown. Now, he says, "We're focused on bringing better access to health care to all of America." B

—*Alexandra Wolfe*



Massoumi's ZocDoc lists 4.1 million doctor's appointments throughout the U.S.

MASSOUMI: PHOTOGRAPH BY LANDON NORDEMAN FOR BLOOMBERG BUSINESSWEEK; STETHOSCOPE: CREATIVE CROP/GETTY IMAGES

MASSOUMI'S BEST ADVICE

1. Invest in customer service

"Great customer service is always important, but it's essential when you're dealing with people's health. That's why we spend most of our marketing dollars on customer service. Patients who use ZocDoc tell their friends and doctors about us and we spread by word of mouth."

2. Stay focused

"It's tempting to try to grow as fast as possible, right from the start. But we chose to stay focused on New York for the first few years. That allowed us to perfect the ZocDoc business model before tackling the challenges of expanding to other cities."

WorldMags

In 1973, Jägermeister and a West German club struck the first known sponsorship deal



Full Frontal Sponsorship

When Barcelona and Man U. battle for the UEFA Champions League title, all eyes will be on their jerseys—among the priciest billboards in sports. *By Roger Bennett*

FC BARCELONA
Sponsor: **Qatar Foundation**

The Most



$40.9 m*

In December the Spanish champs announced a five-year, $204.5 million deal with the Qatari educational organization starting next season.

FC BAYERN MUNICH
Sponsor: **Deutsche Telekom**



$35.7 m

German teams typically lack true global brand power, and eyebrows were raised over the size of this deal with the telecommunications conglomerate.

LIVERPOOL FC
Sponsor: **Standard Chartered Bank**



$33 m

American team owners persuaded this South African bank to pay three times as much as the previous sponsor, Danish brewer Carlsberg.

MANCHESTER UNITED
Sponsor: **Aon**



$32.75 m

The English club made this deal with the Chicago reinsurer after losing its last sponsor, AIG, in the wake of the global financial meltdown.

REAL MADRID CF
Sponsor: **Bwin**



$29 m

The Austrian betting site stepped in when the team's previous sponsor, the Taiwanese electronics company Benq, went bankrupt.

AC MILAN
Sponsor: **Emirates**



$20.5 m

The Silvio Berlusconi-owned club shares the same sponsor as France's Paris Saint-Germain, Germany's Hamburger SV, and England's Arsenal.

TOTTENHAM HOTSPUR
Sponsor: **Autonomy; Investec**



$20.4 m**

The innovative North London team persuaded a software company and an asset manager to sponsor, respectively, its league and cup matches.

CHELSEA FC
Sponsor: **Samsung**



$16.3 m

Financed by Russian oligarch Roman Abramovich, the club gained a reputation for neglecting sponsorship opportunities up until this deal.

MANCHESTER CITY FC
Sponsor: **Etihad Airways**



$12.3 m

This middling club became an instant global heavyweight when it was taken over by Abu Dhabi prince Sheikh Mansour bin Zayed Al Nahyan in 2008.

JUVENTUS FC
Sponsor: **BetClic**



$10.9 m

French bookies are barred from being domestic sponsors, so the gaming site lured Juventus—an Italian club whose past sponsors include Libya's Tamoil.

LA GALAXY
Sponsor: **Herbalife**



$3.5 m-$5 m***

The deal was struck, in 2007, to coincide with the signing of David Beckham. His arrival triggered the sale of 300,000 jerseys.

COLORADO RAPIDS
Sponsor: **None**

The Least



$0

The MLS stipulates that $500,000 is the minimum price for shirt sponsorship—and the league's current champion hasn't found any takers.****

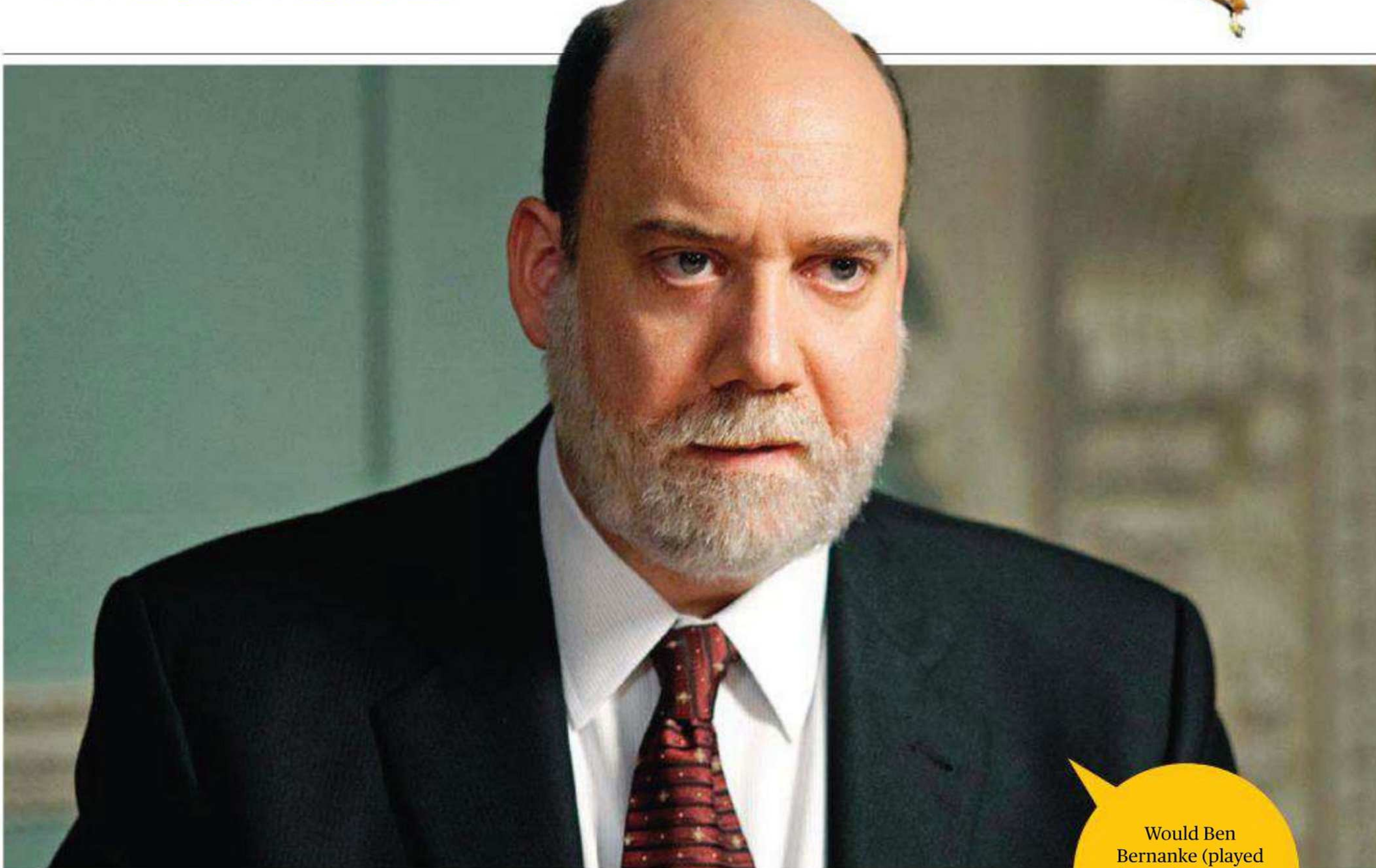
**average annual amount paid by each company **cumulative figure ***figure varies because of team performance incentives ****that's pretty sad*

ILLUSTRATIONS BY MIKEY BURTON; TOP: DPA

WorldMags



The winged hero of the financial crisis



Would Ben Bernanke (played by Paul Giamatti) throw a fit if he had to drink merlot?

Never Waste a Crisis

At last, *Too Big to Fail* lends the financial crisis its Hollywood street cred. *By Bess Levin*

Early on in *Too Big to Fail*, Dick Fuld tells his chief financial officer, Erin Callan, "Screw Warren Buffett—we will stand strong and eat Goldman Sachs's lunch!" It's the first of several lines that reaffirm the old adage that tragedy plus time equals comedy gold. The HBO movie, adapted from Andrew Ross Sorkin's tome of the same name, comes nearly three exhaustively forensic years after Lehman Brothers went bust. And as every HBO subscriber will know, Fuld ended up eating a lot of something else. Yet his mildly hysterical delusions, enhanced by age, are an amusing reminder of the heady months in 2008—at least for those who didn't own Lehman stock.

Too Big to Fail, which premieres on May 23, follows the same trajectory as Sorkin's book, from the collapse of Bear Stearns that spring to the rise of TARP in the fall. To the film's credit, it attempts to make many of these still-horrifying moments pretty funny—and squeezes them all into 98 minutes. While the movie doesn't shed much new light on the period, it offers one of the few pleasures left unfulfilled by the gusher of nonfiction thrillers, roman à clefs, wrist-slapping documentaries, and Oliver Stone. The bankers and government officials who rose to prominence in those months are depicted in all their glory and disgrace by real Hollywood actors—most of whom are far better-looking versions of the people they're portraying. (Tim Geithner is pretty handsome, but Billy Crudup? Really?) TARP groupies will delight in the film's attention to detail. Leon, the coffee cart guy parked outside Lehman's office building, gets a chance to extend his five minutes of fame. The hideous toupee worn by Matthew Modine—playing Merrill Lynch Chief Executive Officer John Thain—might be the worst fake movie hair since Burt Reynolds's heyday.

For the uninitiated, director Curtis Hanson—who won an Oscar for writing *L.A. Confidential*—drops some not-so-subtle hints. A voice-over in an opening scene refers to JPMorgan Chase's Jamie Dimon (Bill Pullman) as the "smart" banker; Lloyd Blankfein (Evan Handler) is called the "superstar"; and Citigroup's Vikram Pandit (Ajay Mehta) is called neither. As Hank Paulson

i

Too Big to Fail
Premieres May 23
9 p.m. EST
(HBO)



WorldMags

(William Hurt) declares, “No one is sure if he’s running Citi or Citi is running him.” Fuld, played in all his vein-popping glory by James Woods, needs no description at all. Viewers are shown, in no uncertain terms, his ginormous hubris as he screws up a potential deal with Korea Development Bank. After being told by Lehman Chief Operating Officer Bart McDade to stay out of the negotiations, Fuld barges in, scares off the bidders, and blows what could have been a precious lifeline.

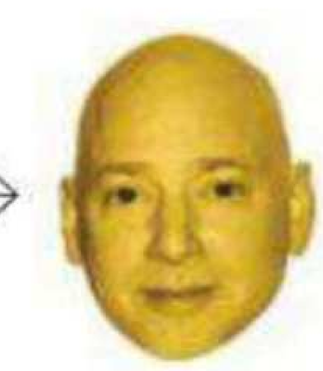
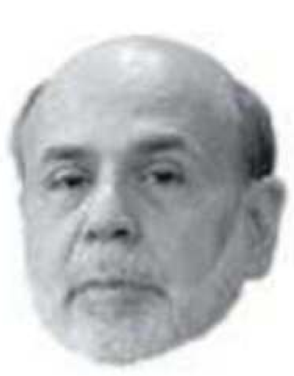
In a deviation from the book, however, *Too Big to Fail* belongs to Paulson. Viewers will experience much of the crisis through his sleepless nights, his afternoons spent vomiting, and his high-minded attempt to save the country from financial ruin—all, in accordance with Christian Science, sans Pepto-Bismol or a single beer. At one point a Treasury staffer offers Paulson some sleeping pills, which the Secretary accepts and then flushes down the toilet. Readers of Paulson’s memoir, *On the Brink*, will remember that the former Dartmouth lineman was sustained during the crisis, in part, by his love of birding. And this unlikely pastime was simply too much for Hanson to ignore. In a scene that probably would have been cut unless it were true, *Too Big to Fail* opens with Paulson staring at a majestic red-tailed hawk outside his living room window.

Paulson’s wingman, Ben Bernanke, receives less screen time, but actor Paul Giamatti makes the most of it. Blessed with the Federal Reserve chairman’s perfectly rounded forehead and jowls, Giamatti literally appears in the shadows—a nod to the Fed’s *éminence grise* role. Giamatti, who might as well have been holding a flashlight under his chin and telling a ghost story, portrays Bernanke as the voice of God—a foil to the more outwardly intense Paulson and Crudup’s wind-up doll version of Geithner. In one scene, Bernanke tells a room filled with congressmen and bank CEOs that they can either do what he and Paulson are telling them or trigger the next Depression. These fist-pumping moments cast a new light on the shy academic—who knew?—and provide some of the best moments in the movie.

Yet these subtle observations are *Too Big to Fail*’s most substantial contribution to the ever-growing financial crisis narrative. The movie ends, as the book does, with the banks’ (begrudging) acceptance of the government’s capital injections and Paulson’s sincere hope Wall Street will lend out some of the $125 billion it’s been given. Yet it didn’t work out that way. Banks lent less than they did before, and the government couldn’t do anything about it. The film ends by acknowledging that the remaining Wall Street institutions are once again too big to fail, which may be good news for HBO. As Sorkin said last December, “I don’t want to write another sequel, but I think there will be one.” B

The Usual Suspects

Assessing the casting decisions in *Too Big to Fail*

REAL-LIFE PLAYER			PORTRAYED BY	ANALYSIS
Tim Geithner		→ 	**Billy Crudup**	Beyond the boyish locks, there isn’t much visual symmetry. Still, Crudup is able to portray Geithner’s utter freaked-outness—and his skill as a jogger and racquetball player.
Dick Fuld		→ 	**James Woods**	Woods nails the worst parts of Fuld—namely how his arrogance brought down Lehman and got in the way of saving it. He also uses his range to show a less-often-seen dignity.
Lloyd Blankfein		→ 	**Evan Handler**	Handler, best known for playing Charlotte’s husband on *Sex and the City*, has the dome to live up to Blankfein’s. And he eerily mimics the Goldman CEO’s goofy expressions.
Ben Bernanke		→ 	**Paul Giamatti**	Giamatti nailed the Fed chief’s facial hair, quietness, and fondness for Dr Pepper. He also mastered his I’m-the-guy-who-knows-exactly-how-this-could-go-wrong persona.
John Mack		→ 	**Tony Shalhoub**	Shalhoub’s attempt at the former Morgan Stanley CEO’s Southern accent misses the mark. (You’re never quite sure where it’s from, but it’s definitely *not* North Carolina.)
Hank Paulson		→ 	**William Hurt**	Hurt spent time fishing with the former Treasury Secretary and apparently picked up on his sense of authority. Yet even the Oscar winner can’t master that gravelly drawl.
Jamie Dimon		→ 	**Bill Pullman**	Pullman, who has experience playing important people (ahem, the President of the U.S. in *Independence Day*), tries for but fails to achieve Dimon’s inimitable silver fox coolness.
John Thain		→ 	**Matthew Modine**	The former Merrill Lynch CEO may have preferred that the worst part of his portrayal be the ridiculous toupee on Modine’s head. Unfortunately for Thain, it’s not.

GETTY IMAGES (10); BLOOMBERG (6)

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Jean-Georges Vongerichten

"The toughest decision is always whether to open a restaurant. Two or three bad months, and you could be out of business"

The master gastronome on modernizing the steakhouse—and deciding to close when the concept wasn't working



A chef and a restaurateur are different jobs: One is about pleasing people with what's on the plate; the other is about understanding the market. I'm a chef, but I think I'm a savvy businessperson, too.


The toughest decision is always whether to open a restaurant. Two or three bad months, and you could be out of business. We have 28 restaurants around the world, and over the years we've killed six. Usually, the license runs out, but sometimes it's the concept. The hardest close was probably V Steakhouse, which I opened at the Time Warner Center in Manhattan in 2004.

I wanted to introduce new flavors into the steakhouse concept. New Yorkers are kind to risk-takers; I thought they would welcome new tastes. A steak is a steak, so I tried to experiment with different side dishes, such as truffle croquettes, and unusual condiments, but I learned that people don't want you to change the steakhouse. They want their Caesar salads and their French fries. The public reaction wasn't good, and the press was negative. It was like I had touched a national treasure.

If we had been in another location, it might have worked. We had to pay such a large rent every month. We were breaking even, but that wasn't enough. You don't do a business for pleasure: You have to make money. We made some touches to the menu, but I didn't want this to be a traditional steakhouse. When we closed at the end of 2005, I had to lay off 150 people. That was painful; each restaurant is like a family business.

I don't think of V as a failure. It was worth the risk. When I moved to Bangkok in 1980 to be a chef at the Oriental hotel, people only wanted foie gras, onion soup, and lots of butter. They wanted apple tarts, when I wanted to use pineapple. If I hadn't taken risks, I would never have started Vong or Jean Georges, or any of my other restaurants. The business can be very fragile, but the best restaurants survive. I prefer to look forward, not back. B *—As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK


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